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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1936.

No. 17.

MECHANICS UNIVERSAL JOINT COMPANY, a Corporation, and GRACE EKSTROM, Administratrix of the Estate of Eric S. Ekstrom, Deceased, *Petitioners*,

v.

A. B. CULHANE, Receiver of the Manufacturers National Bank and Trust Company of Rockford, Illinois, etc., *Respondent*.

BRIEF OF RESPONDENT.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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v.

A. B. CULHANE, Receiver of the Manufacturers National Bank and Trust Company of Rockford, Illinois, etc., *Respondent.*

BRIEF OF RESPONDENT.

STATEMENT OF THE CASE.

The Petitioners' statement omits so much that is material to the consideration of the questions presented in this case that Respondent Receiver deems it necessary to make a concise counter statement.

The Manufacturers National Bank & Trust Company of Rockford, Illinois, closed its doors at 1:30 P. M., Saturday, June 13, 1931, and did not thereafter reopen (R. 187). A Receiver was appointed by the Comptroller of the Currency

on June 16, 1931; an assessment of 100 per cent has since been levied against the shareholders (R. 51); the depositors have been paid dividends of 46 per cent (R. 52) and its assets are insufficient to pay claims in full (R. 52).

Petitioner Ekstrom was the $25,000-a-year president and active manager of the Petitioner Mechanics Universal Joint Company (hereinafter designated the "Joint Company"), and had been such for some years prior to the bank's suspension. He owned 500 shares of the Borg-Warner Corporation, which owned all of the stock of the Joint Company, except the directors' qualifying shares. For two years prior to its suspension Ekstrom had been a director of the bank and had been for more than a year a member of its loan committee. On the last day the bank was open and within a few hours of its closing it paid the Joint Company's check in the amount of $42,716.12 which had been caused to be drawn by Ekstrom and was signed by him as president of the Joint Company.

The situation at Rockford, Illinois, prior to the bank's suspension is accurately restated in part in the following extract (R. 232 to 234) from the opinion of the Circuit Court of Appeals (in which we have inserted record references):

> "On the date the bank closed it was, and for some time prior thereto had been, on a special list of the Comptroller of the Currency for examination every ninety days or oftener, of which fact Ekstrom had knowledge. (R. 28, 39) At about eleven o'clock A. M. June 12, 1931, a meeting of the board of directors of the Manufacturers Bank, called by its president at the request of Mr. Baty, a national bank examiner, was held at the bank at which appellant Ekstrom was present and participated. (R. 39) He there learned from Baty that the Security National Bank of Rockford was unable to continue business and had made a tentative contract with the Swedish American National Bank of Rockford, by which the latter was to take over the former, subject to the appraisal of the former's assets by the latter, and if that appraisal were satisfactory the transfer would be made on Monday morning, June 16,

1931. (R. 39-40) Ekstrom was also there informed by Baty that it was the latter's opinion that the cash position of the Manufacturers Bank was extremely low and could not stand a run of one business day, and that he thought a run on all the banks would occur on Monday whether or not the Security Bank was taken over by the Swedish Bank. (R. 49-50) It was there stated by Baty in the presence of Ekstrom that in view of the continued drain of deposits which the Manufacturers Bank had and was still having, it would be for the best interest of the bank to try to arrange to take the bank's deposit liability under cover. (R. 39) Whereupon the board of directors, with Ekstrom's consent, gave Baty written authority to talk over the affairs of the bank with some other Rockford bank with a view to having the latter take it over. (R. 127) At that meeting Ekstrom knew of the contents of the Comptroller's report of an examination of their bank on December 1, 1930, and he was fully acquainted with the Comptroller's letter of January 8, 1931, which accompanied the report. (R. 28) In that report and letter the Comptroller gave it as his opinion that the bank had loans and discounts which were slow assets in the sum of $1,014,167.09; that there were doubtful loans and discounts to the extent of $228,173.34; and that there were losses since the last examination in the sum of $138,789.96. (R. 28) On June 12, 1931, Ekstrom knew that the Comptroller had requested the bank to send him a letter every thirty days indicating its condition. (R. 28)

The bank was examined about April 27, 1931, and a report of it, together with a letter from the Comptroller, was sent to and received by the bank on or about May 28, 1931, and both were examined by Ekstrom. (R. 30) The report disclosed that there were slow assets of $430,821.34, and losses within the last three months of $19,795.50. (R. 250 to 254) It further disclosed that the directors had direct and indirect liabilities in the bank of $559,620.86. (R. 250 to 254) The letter referred to the condition of the bank as unsatisfactory and dangerously threatening its insolvency and it demanded the directors' immediate attention. (R. 248-249)

At the board meeting of June 12, a committee was appointed by the directors to act for the bank in all mat-

ters relative to taking over its affairs by any other bank. (R. 131) Ekstrom left that meeting about noon, and shortly thereafter executed, as president of appellant, the check which is now in controversy, and caused it to be sent by mail late in the afternoon of that day to the Third National Bank of Rockford. (R. 20-21) Accompanying it was a deposit slip directing its deposit in appellant's general account at the Third National Bank. (R. 128) Theretofore, appellant had never transferred money from its checking account in the Manufacturers Bank to its general checking account in the Third National Bank. (R. 96) The check was received by the Third National Bank on Saturday Morning, June 13th, and was included in the clearings of that day. (R. 11) It was paid by Manufacturers Bank on the same morning, which was the last day that bank was open, and the amount thus paid was deposited as ordered by appellant with the Third National.

About the time Ekstrom signed this check he also signed, as president, another check on behalf of appellant for $35,000. drawn by it against its general checking account in the Security National Bank of Rockford, and it was mailed to the Rockford National Bank. (R. 20)

On Saturday night, June 13, a committee from the Third National, and a like committee from the Manufacturers Bank spent the entire night examining the assets of the latter bank. (R. 40-41) That fact was known by Ekstrom and he was present at the time, and he learned at the conclusion of their examination that it would take $750,000 in cash to effect a merger with the Third National. (R. 41) He also knew that that amount substantially corresponded to the capital, surplus and the undivided profits of the Manufacturers Bank.

On Sunday, June 14, the Manufacturers Bank was insolvent, and by resolution of the board its affairs were placed in the hands of the Comptroller. (R. 126) There had been no appreciable change in its condition from June 12, 1931. (R. 57, 64) From June 6 to June 13, 1931, inclusive of both days, the bank remained open and transacted its usual and ordinary banking business, accepting deposits and paying all checks drawn upon and presented to it, and during that time it

was able to and did meet all its obligations as they matured. (R. 192) The court found that prior to the payment of the controverted check, the bank had committed no act of bankrutpcy.' (R. 193)''

It may further be stated that at the time the Manufacturers Bank paid this sum of $42,716.12 on Saturday morning, June 13, 1931, a few hours prior to its suspension, its directors and managing officers knew, or are chargeable with knowledge of the following facts pertaining to or affecting the bank, *in addition to those restated in the Appellate Court's opinion;*

That a banking crisis existed in Rockford, precipitated by the inability of the Security National Bank to continue in business (R. 39, 112); that there was growing unrest among depositors (R. 49, 64); that their bank's deposits had decreased more than a million dollars in the preceding six months (R. 57, 253 corrected 262); that a run on all banks in Rockford, sound or unsound, was inevitable at the commencement of the next business day (R. 43, 49, 60, 109, 111); that their bank's deposit liabilities approximated $4,200,000.00; that its cash position,—cash on hand in the bank $253,240.06, available deposits in all other banks, $132,562.83, total $385,802.89,—was only sufficient to withstand a run of about three hours' duration (R. 45); that the assets of their bank were frozen (R. 126); that practically no assets remained which could be sold or hypothecated to raise additional cash (R. 42, 71) and that their bank had already pledged approximately $1,600,000.00 (R. 44-71) of its prime assets for deposits accepted or loans obtained.

That there was no reasonable hope at the time of the payment complained of that the Third National Bank or any other sound bank could be induced to take over their bank's liabilities without the payment to it of a large additional sum in cash ($750,000) prior to the commencement of the next business day (R. 51); that the owners of their bank were wholly unable to raise such an amount; that the owners of their bank had been required to contribute a substan-

tial amount in cash and notes in December, 1930, to eliminate questionable assets totalling $397,000 and to permit it to continue in operation (R. 32); that the cash then raised was $50,000 short of the amount sought (R. 83-84); and that in the intervening months, despite the vigorous criticism of the Comptroller and the Examiner, the directors had been unable to reduce (R. 46) their large borrowings and those of their companies, totaling $559,620.86, constituting 31 per cent of the bank's total loans, and containing some of the weakest lines in the bank on which heavy losses were inevitable (R. 249).

QUESTIONS PRESENTED.

(1) Did the Mechanics Universal Joint Company receive a preferential payment or withdrawal of $42,716.12 from its deposit account contrary to the provisions of U. S. R. S. 5242 (U. S. C., Title 12, Sec. 91)?

(2) Was judgment properly rendered against the co-defendant, Eric S. Ekstrom, for repayment of said alleged preferential payment, in view of his connection with the bank, the Joint Company, and his participation in the transaction?

(3) Did the Joint Company have a valid counter-claim against the receivership bank for $20,034.12 (the remainder of its deposit balance at suspension), its contention being that the bank, at the time it received deposits from the Joint Company, during the period May 6 to June 6, 1931, was hopelessly and irretrievably insolvent within the knowledge of its managing officers, and that consequently a trust arose from the acceptance of said deposits enabling the Joint Company to recover said deposits or their proceeds?

SUMMARY OF ARGUMENT.

A.

The Record Establishes that this Payment by the Manufacturers Bank a Few Hours Prior to Its Suspension of $42,716.12 Was Contrary to the Provisions of Section 5242 U. S. R. S., 12 U. S. C. 91, and Was Therefore Void.

B.

The Action of Both Courts Below, Giving the Bank Receiver Judgment Against Petitioner Ekstrom, as Well as Against the Joint Company, Should Be Affirmed.

C.

The Counter-Claim of Petitioner, Mechanics Universal Joint Company, Seeking to Recover Its Deposit Balance at Suspension of $20,034.12 Was Properly Denied by the Courts Below for the Reasons That: (1) No Proof Was Made by Petitioner that the Bank Was Hopelessly Insolvent When It Accepted the Joint Company's Deposits During the Period May 6 to June 6, 1931; (2) No Fraud Was Practiced Upon the Joint Company by the Bank in Accepting the Deposits, in that it Made Said Deposits With the Presumed Knowledge of the Bank's Condition Imputed to it Through Its President, Ekstrom; (3) Assuming, for Discussion Only, that Fraud Was Perpetrated and that Consequently a Trust Relationship Arose in Connection With the Acceptance of the Deposits of the Joint Company Between May 6 and June 6, 1931, There Was No Proof of Augmentation of the Bank's Assets Nor Tracing of the Proceeds of the Deposits to the Assets Taken Over by the Receiver.

D.

If the Judgment of the Court Below is Affirmed the Decree of the Trial Court Should Be Modified to Allow Interest at the Legal Rate on the Amount of the Illegal Payment from the Date Thereof to Repayment Without Crediting the Dividends that Would Be Payable on a General Claim as of the Date Paid Other Creditors.

E.

Additional Comments on Petitioner's Brief.

ARGUMENT.

A.

The Record Establishes that this Payment by the Manufacturers Bank a Few Hours Prior to Its Suspension of $42,716.12 Was Contrary to the Provisions of Section 5242 U. S. R. S., 12 U. S. C. 91, and Was Therefore Void.

Title 12, U. S. C. Sec. 91, provides:

> "Transfers by bank and other acts in contemplation of insolvency. All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding, in any State, county, or municipal court (R. S. 5242)."

The bank Receiver contends that the payment complained of was made at a time when the Manufacturers Bank was hopelessly and irretrievably insolvent within the knowledge of its directors and managing officers, or clearly in contemplation thereof, and after the commission of an act of insolvency, and was made with a view to prevent the application of its assets in the manner prescribed by the National Bank Act or with a view to the preference of one creditor to another.

The trial court found that the Manufacturers Bank was insolvent on Sunday, June 14th, and that there had been no

appreciable change in its position since June 12th, *the day before* the payment complained of. This finding is supported by the record (R. 42, 44, 45, 71, 126). The resolution of the directors closing the bank, passed on Sunday, the day following the payment, recites that its suspension was "due to frozen and non-liquid assets" (R. 126). Consequently, the bank's assets were equally frozen at the time of the payment on Saturday morning. The expected runs on Rockford banks *did* occur at the commencement of the next business day; three Rockford banks suspended on that day (R. 64); and the largest bank in the city, The Rockford National Bank (R. 65), lost in excess of $700,000 in deposits on that day (R. 45). The assets of the Manufacturers Bank would have been equally frozen if taken over by the Third National Bank, and no additional cash could be raised thereon, and the advice received on Sunday that the Third National Bank would require an additional cash payment of $750,000 to assume the liability of the Manufacturers Bank merely confirmed what the directors of the Manufacturers Bank must have known at the time of the payment complained of (R. 51). In this connection the following extract (R. 236) from the opinion of the court below (Circuit Court of Appeals) is in point:

> "The court also found that the bank was insolvent on Sunday, June 14, and that there had been no appreciable change in its condition since June 12, the day of the directors' meeting. That finding we think was supported by material evidence and we can not disturb it. It may be true that none of the officers thought it was insolvent, or contemplated an act of insolvency or the closing of the bank, but *in view of the condition disclosed,* and the reports and correspondence from the Comptroller, together with the advice and suggestions of the examiner, we are convinced that the officers and directors should have known that the bank was insolvent and that closing was imminent. We think the court's findings and conclusions, insofar as they bear on this question, were amply supported by the evidence." (Italics ours)

It was the sworn duty of the directors of the Manufacturers Bank, under the provisions of the National Bank Act, to do what they could to conserve the property of this failing or failed corporation for the benefit of its creditors. The directors should have closed the Manufacturers National Bank & Trust Company of Rockford prior to the commencement of business on Saturday, June 13, 1931, its insolvency at that time being hopeless and irretrievable and its open insolvency being a matter of a few business hours. The opening of the bank for the short business day on Saturday resulted in the dissipation of $107,175.00 of creditors funds (R. 57), which should have been conserved, $52,716.12 thereof having been paid to corporations for which directors Ekstrom and Olson acted as agents (R. 111, 191).

Certainly the conclusion is inevitable that directors Ekstrom and Olson knew that the Manufacturers Bank was hopelessly and irretrievably insolvent and that its open insolvency was imminent at the time of the payment complained of, when we examine their acts and the surrounding circumstances rather than their testimony. *The directors' resolution of the day before authorizing National Bank Examiner Baty to negotiate a sale or merger with another Rockford Bank* (R. 127) *was moved by Olson, seconded by Ekstrom and passed unanimously.* At this meeting Ekstrom asked for the bank's cash position and was advised thereof in round numbers by President Floberg (R. 114). The Third National Bank had been suggested (R. 60-110) and Ekstrom knew that if a takeover was consummated the Joint Company's deposit balance would be automatically transferred to the Third National Bank prior to the commencement of the next business day. That Ekstrom had no hope that a takeover could be consummated is clearly evidenced by his action in transferring most of the Joint Company's funds to the Third National Bank prior to the time this result would be accomplished by a sale or merger.

That Ekstrom had no hope that a sound bank could be induced to take over the liabilities of the Security National Bank is likewise clearly evidenced by his act in transferring $35,000.00 (R. 20) of the Joint Company's funds out of that bank to the Rockford National Bank (the largest bank in the city) before the takeover, if consummated, would be effective at the commencement of the next business day. The Joint Company had never before transferred funds from the Manufacturers Bank to its general account in the Third National Bank and it had never before transferred funds to any other bank except in even amounts (R. 96, 191). In his answer (R. 21) Ekstrom "admits that this defendant caused said money to be drawn out". Ekstrom was insolvent, and included in his large indebtedness was approximately $81,000.00 owed the Manufacturers Bank (R. 53). An assessment was levied on his 85 shares of Manufacturers Bank stock after suspension. The Receiver has been unable to enforce collection of this indebtedness except as to $200 or $300 (R. 53) and an offset of $2,445.00 (R. 106). Ekstrom evidently realized that the situation had become hopeless some time subsequent to June 6, 1931, the date on which the Joint Company's deposits ceased, and on June 12th it is obvious that in drawing out the sum of $42,716.12 he acted to protect his principal remaining asset, his $25,000.00 a year salary and his capital investment in the Joint Company. That Olson, also a director and member of the Loan Committee, who owed the Manufacturers Bank upwards of $50,000.00 (R. 112), had no hope that its early open insolvency could be avoided is clearly evidenced by the transfer he made *by telephone* of $10,000.00 of the deposit balance of the Sundstrand Machine Tool Company, of which he was president (R. 111), from the Manufacturers Bank to a strong Chicago bank at about the time the payment complained of in this case was made. The bank Receiver's action to avoid this payment was filed in the trial court (R. 111).

The intent and purpose of the National Bank Act is stated by this court in *National Bank* v. *Colby,* 21 Wall. 609, 612:

> "The act of Congress prescribes the conditions upon which National banks shall be created; the powers they shall possess; and the consequences of their failure to meet their obligations. *All persons dealing with these institutions can only acquire and enforce rights against them under the limitations there designated.*
>
> * * * * * * * * *
>
> (613) "*As to the general creditors, the act evidently intends to secure equality among them in the division of the proceeds of the property of the bank.* The fiftieth section provides for the appointment of a receiver of an insolvent bank, who shall take possession of its assets, collect its debts, and upon the order of a court of record, sell its real and personal property and pay over the money to the treasury of the United States, *subject to the order of the Comptroller of the Currency;* that the comptroller shall then advertise for creditors to present their claims against the association, and after making provision for refunding to the United States any deficiency in redeeming its notes, *shall make a ratable dividend of the money on all claims proved to his satisfaction or adjudicated in a court of competent jurisdiction.*
>
> "The fifty-second section, *further to secure this equality, declares* that all transfers by an insolvent bank of its property of every kind, and all payments of money made after the commission of an act of insolvency, or in contemplation thereof, with a view to prevent the application of its assets in the manner prescribed by the act, or 'with the view to the preference of one creditor over another, except in the payment of its circulating notes, shall be utterly null and void.'
>
> "*There is in these provisions a clear manifestation of a design on the part of Congress:* 1st, to secure the government for the payment of the notes, not only by requiring in advance of their issue a deposit of bonds of the United States, but by giving to the government a first lien for any deficiency that may arise on all the assets subsequently acquired by the insolvent bank;

and, 2d, *to secure the assets of the bank for ratable distribution among its general creditors.*" (Italics ours) (Statutes printed p. 8 and Appendix p. 51)

The directors of the Manufacturers National Bank, including Ekstrom, subscribed to the oath prescribed by 12 U. S. C. 73 (Appendix p. 52) which provides in part: "Each director, when appointed or elected, shall take an oath that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association and will not knowingly violate or willingly permit to be violated any of the provisions of this title".

THE PAYMENT COMPLAINED OF WAS MADE IN CONTEMPLATION OF INSOLVENCY.

In *National Security Bank* v. *Butler*, 129 U. S. 223, 229, 230, the act found to be a violation of 5242 U. S. R. S., occurred after the directors had voted "(1) to go into liquidation; (2) that the bank be closed to business; (3) that the president, two directors, and another person be a committee to go to Washington and confer with the Comptroller of the Currency as to the measures proper to be taken, and that if the Comptroller should deem it necessary to appoint a receiver," the bank's cashier was recommended for that position. (Page 230, opinion)

This court said (page 231):

> "*It is sufficient, under 5242 of the Revised Statutes, to invalidate such a transfer, that it is made in contemplation of insolvency, and either with a view to prevent the application of the assets of the bank in the manner prescribed by chapter 4 of title 62 of the Revised Statutes, or with a view to the preference of one creditor to another.* Certainly, the transfer in question was made in contemplation of insolvency, made as it was after the directors had voted that the bank should go into liquidation, and should be closed to business, and that a receiver should be appointed; and it was made with a view, on the part of the Pacific Bank and of its

cashier, who represented it and acted for it in this transfer of its assets, to prevent the application of its assets in the manner prescribed by such chapter 4 of title 62, and with a view to prefer the Security Bank to other creditors. The transaction, if allowed to stand, could result in nothing else. The statute made it void, —although there was no such view on the part of the Security Bank in receiving the transfer of the assets; and although there was no knowledge or suspicion at that time on the part of the Security Bank that the Pacific Bank was insolvent or contemplated insolvency, or was not doing business, or that its directors had voted to close it, or that application was to be made for a receiver; and although the transfer took place before the application was actually made to the comptroller for the appointment of a receiver." (Italics ours)

Both courts below held in the instant case that the payment was void because made in contemplation of the bank's insolvency. Had the directors of the Manufacturers Bank performed their sworn duty to protect the interests of creditors, they would have applied for the appointment of a receiver prior to the opening for business on Saturday, June 15. The fact that they did not do so seems immaterial.

We submit that *National Security Bank* v. *Butler, supra,* applies by analogy to the instant case, in that the resolution of the directors the day before authorizing the national bank examiner to negotiate for a sale or merger, was in legal effect a vote that the bank go into liquidation and be closed to business, and was an admission that the rights of creditors became fixed at that time. If it be suggested that the national bank examiner should have closed the bank prior to the opening for business on Saturday, we answer that Section 5242 U. S. R. S. would be violated by any payment made after the rights of creditors had attached to the bank's assets whether the payment be made by the bank's directors or officers or by an examiner, conservator or receiver, performing duties under the National Bank Act.

In *Smith* v. *Baldwin* (Court of Appeals, D. C.) 69 Fed. (2nd) 390, 391, an assistant cashier of the Commercial National Bank of Washington, D. C., withdrew from that bank on the last day it was open for business, deposit balances to his credit as executor and trustee. Despite the fact that Smith was not a director or general officer of the bank, restitution was required on the theory that the bank was in contemplation of insolvency and the statute had been violated. In its opinion the Apellate Court said, at page 391:

> "While the evidence also shows that Smith was not a director or general officer of the bank and likewise that he attended none of the meetings preliminary to the bank's closing, it would nevertheless require more credulity than we possess to accept Smith's statement he did not know the closing of the bank was imminent * * * * * The evidence shows quite clearly that the directors of the bank in surrendering possession realized that unless they should be permitted by the officers of the Treasury to refuse payments on demand, they must surrender. When permission was refused, they immediately turned the bank over to the Comptroller. This alone was evidence of insolvency, for, as the Supreme Court said in McDonald v. Chemical National Bank, 174, U. S. 610, 619, 19 S. Ct. 787, 790, 43 L. Ed. 1106, 'the taking possession of the bank by the comptroller of the currency is a distinct declaration of insolvency.' In Roberts v. Hill (C. C.) 24 F. 571, 573, it is said: '*A bank is in contemplation of insolvency when the fact becomes reasonably apparent to its officers that the concern will presently be unable to meet its obligations, and will be obliged to suspend its ordinary operations.*' See, also, First National Bank v. Andresen (C. C. A.) 57 F. (2nd) 17, and many cases cited there. Here the fact was made certain a month later by the Comptroller's order requiring stockholders to respond to a 100 per cent call.
>
> *Nothing therefore, remains to be considered but the single question whether under the facts shown here Smith withdrew the money in contemplation of the bank's insolvency.* As we have seen, he denies this in the petition filed by him, though he did not himself

testify in the trial. In his petition his explanation is 'he became apprehensive that all banks in the District of Columbia might close' and consequently 'to protect the interests of the beneficiaries of the estate' of which he was executor he withdrew the money. *That the effect of what he did, if we should permit it to stand, would be to protect them and enable them to obtain a preference over other depositors is perfectly clear, and it seems to us equally clear to let it stand would be to disregard the plain mandate of the statute.* We have no doubt Smith's action in the withdrawals of the estate money and of his infant children's was prompted by proper motives, but that the impelling cause was his knowledge that if he delayed the funds would be put in jeopardy by the closing of the bank we think is clearly proved. * * * *The purpose of the statute is to enforce equality of division among all creditors.* The purpose may be defeated in the case of withdrawals by a depositor in the ordinary course of business at any time prior to the closing of the bank, *but a different rule prevails in the case of one who with knowledge of impending disaster seeks to prefer himself.* See Vann v. Federal Reserve Bank (D. C.) 47 F. (2nd) 786, 788, where it is said that *if knowledge of the impending closing of a bank is given a depositor 'as a result of which he is enabled to withdraw his deposit, the effect of such a withdrawal would be to create a preference in his behalf, voidable and recoverable under the express terms of the statute.'*

Smith, though without responsibility for the policy of the bank, was in charge of one of its important departments. *He saw as clearly as any officer or director the steady undermining of public confidence in its stability and the continuous drain on its resources. The atmosphere of the place was surcharged with impending disaster, and his act shows he sensed it fully and sought in his own interest to avoid it. This the statute condemns.''* (Italics ours)

The unreported memorandum of conclusions and order for judgment of the United States District Court, Southern District of California, Central Division, in the case of *N. F.*

Schilling, Receiver, The United States National Bank of Los Angeles, v. *A. Sieroty,* dated August 21, 1934, and printed in the appendix (page 53) finding a transaction to be a violation of Section 5242, U. S. R. S., supports the bank Receiver's contentions in this case.

In *Uhl, Receiver of the Grand Rapids National Bank* v. *First National Bank & Trust Company of Kalamazoo,* which supports our contentions, unreported (appendix p. 59), decided February 15, 1935, and holding Section 5242 U. S. R. S. was violated, the District Court for the Western District of Michigan, Southern Division, Raymond, J., said (p. 59):

> "The parties are in accord upon many of the important facts, and recognize the fundamental principles of law applicable thereto, as stated in Nelson v. Lewis, 73 F. (2d) 521, 523—'If the financial condition of a bank is such that an actual act of insolvency is imminent, and the officers of the bank know or ought to know this condition, a payment to a creditor or depositor is void if not made in the ordinary course of business; an intent to prefer is presumed under such conditions, and as a rule the creditor and depositor need not know of the imminency of the act of insolvency. National Security Bank v. Butler, 129 U. S. 223, 9 S. Ct. 281, 32 L. Ed. 682; Federal Reserve Bank of Kansas City v. Omaha Nat. Bank (C. C. A.) 45 F. (2d) 511; Parks v. Knapp, 29 F. (2nd) 547 (C. C. A. 8); American Surety Co. of New York v. Jackson, 24 F. (2d) 768 (C. C. A. 9); Brill v. McInnes, 14 F. (2d) 306 (C. C. A. 8).'"

A bank is in contemplation of insolvency when the fact becomes reasonably apparent to its officers that the concern will presently be unable to meet its obligations and will be obliged to suspend its ordinary operations.

First National Bank of Ortonville v. *Andresen,* 57 Fed. (2d) 17, 19.
Parks v. *Knapp,* 29 Fed. (2d) 547, 549.
Browne v. *Stronach,* 7 Fed. (2d) 685, 687.
U. S. Pipe & Foundry Co. v. *City of Hornell,* 146 Misc. 812; 263 N. Y. Supp. 89, 95, 96.

In referring to the bank's officers in *Parks* v. *Knapp, supra,* the court said:

> "They doubtless hoped to defer the event indefinitely, by concealing the real condition of affairs; but they took counsel of their hope and not of their judgment when they contemplated any prolonged postponement."

In *Brill* v. *McInnes,* 14 Fed. (2d) 306, the court said:

> (p. 307) "The hopeless insolvency of the bank was within the contemplation of the officers, if they would contemplate it; that they did not, should not, it seems, take the case out of the statute. The insolvency of the bank was before them and with it before them they gave this creditor a preference. This seems to be within the statute."

If the financial condition of the bank is such that the officers knew or ought to have known that insolvency was imminent, then a payment to a depositor is void if not made in the ordinary course of business; *an intent to prefer is presumed under such conditions even though the depositor did not know the imminency of the insolvency.*

Nelson v. *Lewis,* 73 Fed. (2d), (C. C. A. 2) 521, 523.

Also see:

Federal Reserve Bank v. *Omaha National Bank,* 45 Fed. (2d) 511, 515.
Roberts v. *Hill,* 24 Fed. 571, 574.
Browne v. *Stronach,* 7 Fed. (2d) 685, 687.

Where one receives his deposit from a bank which contemplates insolvency, and he has acquired information of the facts from a confidential source connected with the bank, *the transaction is not in the ordinary course of business and may be avoided as a preference.*

Fed. Res. Bank v. *Omaha National Bank* (C. C. A. 8th), 45 Fed. (2d) 511, 515; (Certiorari denied 283 U. S. ~~901~~ 902).

The case of *Vann* v. *Federal Reserve Bank of Richmond, supra,* is not unlike the instant case and the court there distinguishes the facts presented from the case of *McDonald* v. *Chemical National Bank,* 174 U. S. 610.

Ordinary Course of Business.

One of the important questions for determination in this case is whether, under the facts here presented, the payment complained of was made in the ordinary course of business because the bank, at the time, was meeting the demands of other depositors who had no information concerning its condition. The bank Receiver contends that this payment was not in the ordinary course of business because it was actuated by Ekstrom's knowledge of the bank's insolvency. Payments by a bank in the ordinary course of business without knowledge on the part of the customer that the bank is insolvent cannot be attacked under the illegal preference section but a different rule applies to one who with knowledge of the impending disaster seeks to prefer himself or his principal. The rule we contend for is stated by Mr. Justice Groner in speaking for the Appellate Court in *Smith* v. *Baldwin, supra,* and as a District Judge in *Vann* v. *Federal Reserve Bank,* where he said:

Smith v. *Baldwin,* 69 Fed. (2nd) 390, 392:

> "The purpose of the statute is to enforce equality of division among all creditors. The purpose may be defeated in the case of withdrawals by a depositor in the ordinary course of business at any time prior to the closing of the bank, *but a different rule prevails in the case of one who with knowledge of impending disaster seeks to prefer himself.*" (Italics inserted.)

Vann v. *Federal Reserve Bank of Richmond,* 47 Fed. (2nd) 786, 787:

> "The Reserve Bank, however, insists that, notwithstanding all that is said above, the payment of the

checks in question was not a preference because it was a payment in the ordinary course of business, and was in all respects analogous to the payment of checks of depositors made in the ordinary course, but after the insolvency of a bank and with knowledge of the same on the part of its officers. Whatever rights a receiver of an insolvent bank may have against a depositor of the bank, who without knowledge of its insolvency withdraws his money a day or two before failure, it is not necessary here to decide, *but there can be no doubt, I think, that, if there be added to the facts stated in the foregoing proposition knowledge on the part of the depositor of insolvency, the transaction, even though apparently in the ordinary course of business, would be subject to be set aside and annulled as in conflict with the statute,* for if, as sometimes happens, knowledge of the impending closing of a bank is given a favored depositor as a result of which he is enabled to withdraw his deposit, the effect of such a withdrawal would be to create a preference in his behalf, voidable and recoverable under the express terms of the statute." (Italics inserted.)

In *American Surety Company of New York* v. *Jackson* (C. C. A. 9), 24 Fed. (2nd) 768, 769, Larson was cashier of the bank and treasurer of the City of Payette. Just prior to suspension Larson withdrew the sum of $4322.77 to the city's credit, placed the funds in a sack and transferred the sack to another bank. It was held the transaction violated the illegal preference section.

Thus it appears that the knowledge of the depositor concerning the bank's condition and how he acquired that knowledge is important in determining the question of whether or not the transaction was in the usual course of business. Where the depositor occupies a fiduciary relation to the bank and thus acquires knowledge of its condition, his act of withdrawal of depositary funds is not in the ordinary course of business.

Aycock v. *Bradbury* (C. C. A. 10th), 77 Fed. (2d) 14, 17;

First National Bank of Ortonville v. *Andresen* (C. C. A. 8th), 57 Fed. (2d) 17, 19;
Federal Intermediate Credit Bank of Omaha v. *L'Herisson* (C. C. A. 8th), 33 Fed. (2d) 841, 846, 847.

In *Federal Reserve Bank* v. *The Omaha National Bank* (C. C. A. 8th), 45 Fed. (2d) 511, 518, 519, the transaction occurred while the bank was open but the beneficiary had knowledge that the bank was insolvent, and the payment was held void under Section 5242 U. S. R. S.

In the case of *George* v. *Wallace,* 135 Fed. 286, 295, the Circuit Court of Appeals, 8th Circuit, said:

> "The expression 'usual course of business', as one of limitation upon the powers of a corporation is generally referrable to the activities of a going concern *and has little if any application to one which is upon the threshold of liquidation because of insolvency.*" (Italics inserted.)

We therefore submit that the facts in the instant case require the application of the foregoing rule to the payment to the Joint Company now under consideration, and the affirmance of the Trial Court's conclusion of law No. 9 (R. 194), which reads:

> "(9) The funds of the Mechanics Universal Joint Company were not transferred from its checking account in the Manufacturers National Bank and Trust Company in the usual and ordinary course of business."

The Payment Was Made After the Commission of An Act of Insolvency.

While this record establishes the soundness of the conclusion of both courts below that the payment complained of was made in contemplation of insolvency, we submit that it can also be held that the bank was hopelessly and irretrievably insolvent at the time of the payment and that prior thereto it had committed an act of insolvency. The

directors of the Manufacturers Bank were the agents of its shareholders to conduct a banking business and were without power to cease operations or to sell the assets to another bank *unless* such action was necessary to protect the interests of creditors. To quote from *City National Bank of Huron* v. *Fuller* (C. C. A. 8), 52 Fed. (2nd) 870, 873:

> "*It is the duty of directors of a failing corporation to do what they can to conserve the property for the benefit of the creditors.* If a concern is in fact a going concern, the board of directors ought not to be permitted to strike it down by selling all its assets. The situation is entirely different when the corporation is not a going concern, and a corporation on the verge of insolvency is not going far.
>
> "In George v. Wallace, 135 F. 286, this court pointed out that the expression 'usual course of business' has reference to a going concern and not to a concern on the threshold of insolvency. The rule is stated in 3 Thompson on Corporations, 2429, as follows: '*Where the corporation is in failing circumstances, or is in fact insolvent, the directors and managing officers may dispose of all the property, or make an assignment of all the corporate property for the benefit of creditors.*' (Citing authorities.)
>
> "These cases hold that under general law, in the absence of restrictions national or state prohibiting it, directors of corporations may under certain circumstances mortgage or pledge the corporate assets; may make an assignment for the benefit of creditors; may throw the corporation into bankruptcy. While most of them do not involve National banks, they discuss the general powers of boards of directors under circumstances analogous to those presented here, and we think they are applicable in considering the question of what is the 'ordinary business' of the banking corporation. Under the National Banking Act section 24(7), Title 12, U. S. C. A., directors are given 'all such incidental powers as shall be necessary to carry on the business of banking.' Such business includes the meeting of the bank's liabilities.
>
> "We do not think section 181, title 12, U. S. C. A., has any application here, as there was no voluntary dissolu-

tion of the corporation we are dealing with, and said section is applicable only to a solvent bank. Planten v. National Nassau Bank, 174 App. Div. 254, 160 N. Y. S. 297; Planten v. Earl, 220 N. Y. 677, 116 N. E. 1070.

"It has become something of a custom of National banks to take over other banks in failing circumstances, and this has received the approval of the Comptroller of the Currency. If the transaction is a fair one, it is in the public interest. This court in Schofield v. State National Bank of Denver, Colorado, 97 F. 282, held the taking over of the assets and the assumption of liabilities of another bank was within the power granted to directors of National banks by section 24(7), title 12, U. S. C. A., supra. In construing a transaction between two National banks in First National Bank v. Harris, 27 F. (2d) 117, 124, this court said: 'It was an out and out sale of assets in consideration of an assumption of liability with an accounting over for any surplus realized.' (Citing authorities.)

"Without further discussion, we may say that in our judgment the transaction between the First National and the City National was not, in view of the approaching insolvency of the City National, ultra vires." (Italics ours)

The trial court found, in effect, that the Manufacturers Bank was insolvent on June 12, 1931. We submit that the resolution of the banks Board of Directors passed on that date, moved by Olson and seconded by Ekstrom, was in legal effect an admission by the board of directors that the rights of creditors had attached. The situation is not unlike that presented to the Circuit Court of Appeals for the Third Circuit in *Port Newark National Bank* v. *Waldron*, 46 Fed. (2nd) 296, where an attempt was being made to effect an assumption of liabilities just before a bank suspended and wherein the court held that the rights of creditors attached when the Bank Examiner's activities commenced and before the Receiver was appointed, stating:

(page 297): "In pursuance of such appointment, Peterson, immediately took possession of, and closed, the bank. It thus appears that the Comptroller,

through his bank examiner, was engaged in supervising the bank on August 7th, and, when advised the proposed sale could not be effected, immediately appointed a Receiver. *It is clear that on August 7th, and from then on, the Comptroller was exercising his supervisory powers, and had assumed direction and control of the affairs of the bank with reference to its proposed sale.*" (Italics inserted)

(page 298): "From the above it will be seen that on and from August 7th the Comptroller was, first by his bank examiner and later by his receiver, performing the duties of supervision and possession vested in him by Federal law and that his receiver was 'the agent and officer of the United States' in possession of the bank and its assets."

(page 299): "Sufficient to say that in the present case we regard the Comptroller at the time this bill was filed as having complete dominion over, and, by his bank examiner, full legal control of, the then and future operations of the bank, and that such situation might ultimately require the appointment of a Receiver."

We submit that under the above authorities the court below could have held, and this court can now hold, *that the resolution of the Board of Directors of the Manufacturers Bank, passed the day before the payment, authorizing the bank Examiner to negotiate a sale or a merger was an act of insolvency and that consequently the rights of creditors attached to the bank's assets as of June 12, 1931.*

Weight to Be Given Concurrent Findings of Facts by the Two Courts Below.

It is settled that this court will not disturb findings of fact made by a District Court in equity, concurred in by the Circuit Court of Appeals, except in cases of clearest error. *Charleston, S. C., Min. & Mfg. Co.* v. *United States*, 273 U. S. 220, 223; *Page* v. *Rogers*, 211 U. S. 575, 577. In its finding of fact No 22 in this case (R. 192) the trial court said: "On Sunday, June 14, 1931, said bank was in fact insolvent

and there had been no appreciable change in its condition from June 12, 1931." Referring to this finding the Appellate Court said in its opinion (R. 236) "That finding, we think, was supported by material evidence and we cannot disturb it."

What is designated by the trial court as a conclusion of law will be treated on review as a finding of fact if essentially of that character. 4 C. J. 645. The trial court's conclusions of law 8 and 9 (R. 194) are:

> "(8) The directors of the bank knew its condition to be as found above and placed its officers in position to pay the check in question, drawn by one possessing knowledge of the bank's condition which he acquired because he held a confidential position in the bank and thereby learned facts not known to depositors generally. The payment of the check in fact created a preference and it must be held in law the parties intended the result of their acts.
>
> (9) The funds of the Mechanics Universal Joint Company were not transferred from its checking account in the Manufacturers National Bank & Trust Company in the usual and ordinary course of business."

The conclusion of law No. 5 (R. 193) recites that in causing the check to be drawn and paid, Ekstrom "then and there intended to prefer the defendant corporation over the other creditors of said bank and intended to prevent the assets of said bank from being distributed ratably, and that his act in so doing was in violation of Section 5242 of the Revised Statutes of the United States, and was an act done in contemplation of insolvency of said Manufacturers Bank."

We submit that the trial court found as a fact that the payment complained of was made in contemplation of insolvency and after the bank had become insolvent and that this finding of fact was concurred in by the Appellate Court in the following excerpts from its opinion (R. 236):

> "It may be true that none of the officers thought it was insolvent, or contemplated an act of insolvency or

> the closing of the bank, but in view of the condition disclosed, and the reports and correspondence from the Comptroller, together with the advice and suggestions of the examiner, we are convinced that the officers and directors should have known that the bank was insolvent and that closing was imminent. We think the court's findings and conclusions, in so far as they bear on this question, were amply supported by the evidence. * * * It would serve no good purpose to set forth the evidence in detail. A perusal of the entire record convinces us that with respect to both appellants, the court's findings are supported by direct material evidence as well as by logical and legitimate inferences."

We submit that this court should not disturb the trial court's findings of fact in this case concurred in by the Circuit Court of Appeals.

B.

The action of both courts below giving the bank receiver judgment against petitioner Ekstrom as well as against the Joint Company should be affirmed.

Petitioner Ekstrom, as a director of the Manufacturers National Bank subscribed to an oath which provided "that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association and will not knowingly violate or willingly permit to be violated, any of the provisions of this title." (Appendix, p. 52.) The bill of complaint, paragraph 4, (R. 5) alleges that Ekstrom's action "* * * was in violation of the laws of the United States with reference to national banks * * *." In addition to the specific duties defined in the National Bank Act a director of such a bank is under a common law obligation to the depositors as well as the shareholders to exercise at least ordinary care and prudence in the supervision and administration of the bank's affairs (*Bowerman* v. *Hamner*, 250 U. S. 504, 512, 513). The bank Receiver contends that

Ekstrom knowingly violated the National Bank Act, or willingly permitted it to be violated incident to the payment complained of; that he did not diligently administer the affairs of the bank and that he was negligent in the performance of his duties, which made him personally liable for the loss sustained by the bank, and justified the personal judgment rendered against him in this case by both courts below.

The bill of complaint in this case is drawn to meet the above propositions. It is correct pleading, for this court has said:

> "And there is no sound reason why a bill may be not so framed that, if the evidence fails to establish statutory negligence but establishes common law negligence, a decree may be entered accordingly, and thus the necessity for a resort to a second suit avoided." *Bowerman* v. *Hamner, supra;* p. 511. Also see: *Briggs* v. *Spaulding,* 141 U. S. 132, 142, 165.

As stated in the opinion of the court below, in the instant case:

> "But the bill did not wholly rely upon section 91 for a recovery. It also pleaded a charge of common law negligence. That this is a proper practice cannot be doubted. Bowerman v. Hamner, 250 U. S. 504." (R. 236.)

The object of the statute is to secure equal distribution, and to prohibit conduct which the officers of the insolvent bank can perceive, in the exercise of reasonable foresight, will prevent the fulfillment of that object.

> *First National Bank of Ortonville* v. *Andresen,* 57 Fed. (2d) 17-20.

Directors cannot, in justice to those who deal with the bank, shut their eyes to what is going on around them.

> Bowerman v. Hamner, 250 U. S. 504, 514.

In determining whether an insolvent bank payment, withdrawn on the last day it was open for business, was intended to give an unlawful preference, the managing officers are held charged with full knowledge of the bank's condition.

South Carolina State Bank v. Stokes, 168 S. E. 541, 544.

It is the duty of a bank director to keep in touch with the general affairs of the bank, and where the bank is in failing condition over a period of months, and the director has full opportunity to observe that condition, he will not be heard to say that he did not do so. Hatfield v. Lamb, 185 S. E. 229, 230.

In Robinson v. Hall, (C. C. A. 4) 63 Fed. 222, 228 it was said:

> "If directors are depositors, and know two months or more before suspension that that event is inevitable, and that the bank can pay only a percentage of its deposits, and yet check for the whole of their own balances, thereby diminishing the percentage to which other creditors would be entitled, they certainly defraud, to the extent of the diminution, the creditors whose interest they are relied upon to protect, and should be held to strict accountability."

THE RELATION OF EKSTROM TO THE BANK AND THE JOINT COMPANY.

> "The relation of Director to corporation is of such a fiduciary nature that transactions between Boards having common members are regarded as jealously by the law as are personal dealings between a Director and his corporation, and where the fairness of such transaction is challenged, the burden is upon those who would maintain them to show their entire fairness; * * * this court has been consistently emphatic in the application of this rule which it has declared, is founded in soundest morality, and we now add, in the soundest business policies."

Geddes v. *Anaconda Mining Co.*, 254 U. S. 590, 599.

Where a Clearing House was the agent and fiduciary representative of all the banks forming the Clearing House, this court referred to the Clearing House as "the fiduciary agent of the banks."

Yardley v. *Philler*, 167 U. S. 344, 359.

Where the President of a corporation *actually acts for the corporation*, it would be a travesty to say his knowledge relating to the very thing which he was doing, would not bind his corporation, however the knowledge was acquired.

21 R. C. L. Page 841, Sec. 22
3 Fletcher Cyc. Corp., page 71, Sec. 811
3 Fletcher Cyc. Corp., page 42, Sec. 797

"There is no other officer or agent to whom notice could have been made with more propriety."

Porter v. *Bank of Rutland*, 19 Vt. 410, 425

Where two attorneys and agents of a corporation purchased at a sale property for the corporation, this court said, "They and the company may both be considered as purchasers at the sale."

Minnesota Co. v. *St. Paul Co.*, 69 U. S. 609, 634

Where the element of duress or forced payment *or of knowingly participating in an unlawful act exists*, the rule is, the fact that the relationship of principal and agent exists, does not relieve the agent, whose personal participation made possible the wrong committed. *In such cases both the principal and agent are wrongdoers and may be sued jointly or severally.* This is true even though the agent did not profit thereby. The act was obviously wrong and the party participating in such a wrong may not exonerate himself by showing that he was acting for another.

Vann v. *Fed. Res. Bank of Richmond*, 47 Fed. (2d) 786, 788:

> "The defendant, though acting as agent, actively participated in the commission of the tort, and judgment was rightly rendered against both defendants."
>
> *First Nat'l Bank & Trust Co.* v. *Manning,* 116 Conn. 335; 164 Atl. 881, 883.

In *Hirning* v. *Fed. Res. Bank,* 52 Fed. (2d) 382-387, it was contended that the bank was merely an agent and therefore could not be held liable. The Circuit Court of Appeals held that it was liable notwithstanding it acted as agent, and in that connection said:

> "The Reserve Bank participated in those transfers • • •; The action of the Reserve Bank as agent helped bring about the preference. What the Reserve Bank did, it did with full knowledge of the insolvency of the Brookings Bank."

A suit was brought against a bank on the theory that it was liable for a fund by reason of having knowingly participated in a wrongful withdrawal. The Supreme Court of Arkansas said, "The theory is correct, and if the evidence in the case sustains a finding that appellee bank participated in the unlawful act, the banking commissioner is entitled to recover for the creditors of the defunct bank the amount of the funds thus wrongfully diverted."

Rainwater v. *Merchants Nat'l Bank,* 288 S. W. 388, 389.

C.

The counter-claim of petitioner, Mechanics Universal Joint Company, seeking to recover its deposit balance at suspension of $20,034.12 was properly denied by the courts below for the reasons that: (1) No proof was made by petitioner that the bank was hopelessly insolvent when it accepted the Joint Company's deposits during the period May 6 to June 6, 1931; (2) no fraud was practiced upon the Joint Company by the bank in accepting the deposits, in that it made said deposits with the presumed knowledge of the bank's condition imputed to it through its president, Ekstrom; (3) assuming, for discussion only, that fraud was perpetrated and that consequently a trust relationship arose in connection with the acceptance of the deposits of the Joint Company between May 6 and June 6, 1931, there was no proof of augmentation of the bank's assets nor tracing of the proceeds of the deposits to the assets taken over by the Receiver.

To establish the right it asserts to receive a priority payment, in any amount, from the assets of the Manufacturers Bank that passed into the hands of the Receiver, the Joint Company must affirmatively prove (1) that the relationship existing was that of trustee and cestui que trust and not that of debtor and creditor, (2) that the deposits in question augmented the assets of the bank and (3) that the proceeds thereof passed into the hands of the Receiver. All doubts must be resolved in favor of the Receiver who is the trustee for the general creditors. Texas & Pacific R. R. Co. v. Pottorff, 291 U. S. 245, 261, Note 19; Schuyler v. Littlefield, 232 U. S. 707, 713; Adams v. Champion, 294 U. S. 231; Cook County National Bank v. United States, 107 U. S. 445, 448.

While the Manufacturers Bank may have been insolvent prior to June 12, 1931, the Bank Receiver submits that it became hopelessly and irretrievably insolvent *for the first*

time on that date. To quote from this court's opinion in Easton v. Iowa, 188 U. S. 220, 232:

> "Whether a bank is or is not actually insolvent may be, often, a question hard to answer. There may be good reason to believe that, though temporarily embarrassed, the bank's affairs may take a fortunate turn. Some of the assets that cannot at once be converted into money may be of a character to justify the expectation that, if actual and open insolvency be avoided, they may be ultimately collectible, and thus the ruin of the bank and its creditors be prevented. McDonald v. Chemical Nat. Bank, 174 U. S. 610. But, under the state statute, no such conservative action can be followed by the officers of the bank except at the risk of the penalties of fine and imprisonment. In such a case the provisions of the Federal statute would permit the Comptroller to withhold closing the bank, and to give an opportunity to escape final insolvency. It would seem that such an exercise of discretion on the part of the Comptroller would, in many cases, be better for all concerned than the unyielding course of action prescribed by the state law."

Notwithstanding the frozen condition of the assets of the Manufacturers' National Bank and Trust Company and the losses from time to time sustained, finding of fact numbered 23 of the trial court (R. 192) indicates *that up to June 12, 1931,* the bank had been transacting its usual and ordinary banking business and had been meeting its current obligations from time to time as they accrued. Assuming, for discussion only, that the bank was actually insolvent prior to June 12th from the standpoint of the balancing of the fair value of its assets against its total liabilities, it should be observed that it is only when the bank is hopelessly and irretrievably insolvent that it becomes wrongful for it to accept deposits in regular course of business. See *Easton* v. *Iowa, supra,* page 232; *St. Louis Railroad Company* v. *Johnston,* 133 U. S. 566, 577; and *Quin* v. *Earle,* 95 Fed. 728, 732. No proof was adduced by petitioner indicating that the bank was hopelessly and irretrievably insolvent (as

distinguished from asset insolvency) during the period May 6 to June 6, 1931, in which the deposits sought to be recovered were accepted by the bank.

The situation of the Manufacturers' Bank became acute when the banking crisis arose in Rockford, precipitated on June 12, 1931, by the inability of the Security National Bank to continue in business (R. 39-112) and the inability of the Manufacturers' Bank,—by reason of its small cash balance compared to its outstanding liabilities,—to meet the run which was expected to occur on Monday, June 15th, and which did occur on June 15th, on the remaining banks (R. 64, 65); and further the inability of the Manufacturers' Bank to arrange for a take-over by the Third National Bank (R. 51).

Of course, when the Manufacturers' Bank became unable, whether by reason of the banking crisis, or by reason of its progressively precarious condition, to meet demands which might be made upon it as a banking corporation, it became insolvent in law. A banking corporation differs from other corporations and individuals so far as the status of insolvency is concerned. Other corporations and individuals are insolvent only when their assets are insufficient to meet their liabilities (in contemplation of bankruptcy and insolvency laws), whereas banks are considered insolvent when they are unable to meet their current demands, and the demands of their depositors over the counter, notwithstanding they may have frozen assets, which, together with their other assets, may equal their liabilities. As stated in Steele v. Randall, 19 Fed. (2) 40, 41:

> "Insolvency is a condition unaffected by intentions or hopes of the persons affected. When the bank could not meet its obligations as they became due it was insolvent."

Also see United States v. Oklahoma, 261 U. S. 253, 261.

Even though this court should not accept the conclusion of both courts below that the counterclaim should be dis-

missed on the theory that no fraud was practiced on the Joint Company in that it was not an innocent depositor by reason of the knowledge and acts of its president, we respectfully suggest that it is unnecessary for this court to determine the relationship between the Joint Company and the Manufacturers' Bank with reference to the deposits complained of *because the record contains no proof that any of the deposits augmented the assets of the bank or that any part of the proceeds have been traced into the hands of the Receiver.* Mr. Justice Parker, speaking for the Circuit Court of Appeals for the Fourth Circuit in Poole v. Elliott, 76 Fed. (2nd) 772 summarizes the law applicable at page 774:

> "And, even if the bank were hopelessly and irretrievably insolvent at the time of the receipt of the deposits, this fact would not give preferential status to the claim of the depositor. It is true that the acceptance of a deposit under such circumstances is a fraud on the depositor, for which he may rescind the contract and recover the deposit or ask that a constructive trust be declared in his favor upon its proceeds. St. Louis & S. F. R. Co. v. Johnston, 133 U. S. 566, 10 S. Ct. 390, 33 L. Ed. 683; Quin v. Earle, (C. C.) 95 F. 728, Illinois Cent. R. Co. v. Rawlings (C. C. A. 5th) 66 F. (2nd) 146. But before such trust will be enforced against a receiver, who represents creditors as well as the bank, *it is indispensable that clear proof be made that the trust property or its proceeds has gone into a specific fund which has come into his hands, or into a specific identified piece of property, or has directly augmented a fund upon which the trust is to be declared. It is not sufficient to prove merely that it has gone into the general estate and has presumably increased its amount and value.* Edisto Nat. Bank of Orangeburg v. Bryant (C. C. A. 4th) 72 F. (2nd) 917; Santee Timber Corporation v. Elliott (C. C. A. 4) 70 Fed. (2nd) 179, 93 A. L. R. 874; Swan v. Children's Home Society (C. C. A. 4) 67 Fed. (2nd) 84; Lifsey v. Goodyear Tire & Rubber Co. (C. C. A. 4th) 67 F. (2nd) 82; Harmer v. Rendleman (C. C. A. 4) 64 F. (2nd) 422. *Here there was neither allegation nor proof tracing the proceeds of the deposits by*

petitioner into the hands of the receiver; and, on the authority of the cases last cited, we must deny relief to petitioner even if we construe the prayer of his petition as sufficiently broad to ask that a trust in his favor be declared and not merely that his claim be granted preferred status." (Italics ours.)

If the Joint Company's deposits between May 6th and June 6th, 1931, were accepted under conditions of known insolvency so were those of all depositors made during that period and the cash that passed to the Receiver would be insufficient to pay such claims. To again quote Mr. Justice Parker in the Poole case (p. 775):

"* * * it is clear that other depositors as to deposits made during this period are entitled in equity to the same relief as petitioner, and in granting relief the court should see that their rights are protected. In such cases, therefore, the establishment of a trust in favor of depositors on the ground of hopeless and irretrievable insolvency would affect a large part of the obligations to depositors and probably all of the cash assets passing into the hands of the receiver; * * *"

The Joint Company alleges (R. 14, 15, 21) that it "made deposits of its money and of its checks and bills of exchange." Under the record all of the deposits might have consisted of checks drawn on accounts already in the Manufacturers Bank, the payment of which would result in mere transfers of bookkeeping credits and a general claim. Old Company's Lehigh v. Meeker, 294 U. S. 227, 230; Blakey v. Brinson, 286 U. S. 254, 263. If any of the checks deposited were drawn on outside banks and collected through credits with correspondent banks no proof is made that the proceeds passed to the Receiver. As stated by this court in Adams v. Champion, 294 U. S. 231, 239: "Evidence is lacking that it was withdrawn in such a form or for such purposes as to be represented by any assets forming part of the estate today." The record contains no proof that any cash con-

tained in the deposits was not dissipated before the Receiver arrived. The amended counterclaim (R. 25) does allege that $400,000 in cash passed to the Receiver but absolutely no proof is made that this fund contained one penny of the proceeds of any of the Joint Company's deposits. The bank Receiver submits that the denial of the counterclaim should be affirmed for the reasons stated by the courts below but in any event because of the Joint Company's complete failure to prove augmentation and tracing of funds to the Receiver.

D.

If the judgment of the courts below is affirmed, the decree of the trial court should be modified to allow interest at the legal rate on the amount of the illegal payment from the date thereof to repayment without crediting the dividends that would be payable on a general claim, as of the date paid other creditors.

The facts and circumstances of this case require the bank Receiver, acting as trustee for depositors, to urge this court to modify the decree of the trial court with reference to interest, to permit the Receiver to recover the full amount of the payment, plus interest thereon at the legal rate from June 13, 1931, to repayment, without crediting the dividends paid creditors, as of the dates paid, as was done by the trial court, but permitting the Joint Company to now prove its general claim and receive dividends thereon, without interest, its failure to receive the dividends heretofore paid being due exclusively to its delay in presenting the general claim.

The trial court's conclusion of law No. 3 (R. 193) reads: "The plaintiff is entitled to a decree as prayed for in the bill." The bill of complaint (R. 6) prays:

> "That said defendants and each of them, be ordered and directed by this court to return to the plaintiff said sum of $42,761.12, together with interest at the rate of

5 per cent per annum from said June 13, 1931, to the date said fund is returned to said Receiver."

The trial court's decree (R. 195) allows the appellant's credit for the dividends as of the dates paid and contains the following paragraph:

"It further appears to the court that four dividends have been ordered and have been paid on general claims, by the Receiver, and that the amounts to which the defendants would be entitled on the sum of $42,761.12 if said last mentioned sum had been allowed as a claim against the said bank and the dates when the same would have been payable are as follows: December 3, 1931, $10,690.28. March 16, 1932, $4,276.11. August 11, 1932, $4,703.72. April 11, 1934, $2,138.06."

It is true that this incidental question was not raised in the court below but this court can, and, we submit, should under the circumstances here presented, notice this error apparent on the face of the record. The reasons urged by the bank Receiver as warranting special consideration by this court to the depositors, the real parties in interest, are stated as follows by Mr. Justice Taft speaking for the Circuit Court of Appeals for the Sixth Circuit in Chemical National Bank v. Armstrong, 65 Fed. 573, 574:

"The fact that the point was not pressed by counsel for the receiver at the original hearing doubtless vested a discretion in this court to refuse to rehear the issue now urged. We would not by our action in this case wish to establish a precedent that this court will rehear any case upon a question lurking in the record, and not pressed at the first hearing, because, in a subsequent decision of the Supreme Court, a principle is established by which such question must be decided in a different way, and a different conclusion in the case reached. In this case, however, the moving party is a trustee appointed, not by the beneficiaries, but by the Comptroller of the Currency, and we feel disposed to exercise the discretion which we have in favor of a trust

fund thus administered, which we might not exercise in favor of parties representing their rights in person."

The illegal preference section declares payments made in violation thereof "utterly void" from which it follows that the Joint Company obtained no rights under the payment but only the duty to make restitution, plus interest. Section 193, Title 12, U. S. C. provides "The Comptroller shall, upon appointing a Receiver, cause notice to be given by advertising in such newspapers as he may direct for three consecutive months, calling on all persons who may have claims against such association to present the same, and make legal proof thereof." Section 194, Title 12, U. S. C. (App. p. 51) requires the Comptroller to make a ratable dividend "on all such claims as may be proved to his satisfaction or adjudicated in a court of competent jurisdiction."

Despite the publication of notice to file claims pursuant to the statute the Joint Company has never proved to the satisfaction of the Comptroller or had adjudicated by a court its general claim in the amount of $42,761.12, consequently it never became entitled to receive the dividends paid the bank's creditors as of December 3, 1931, December 16, 1932, August 11, 1932, and April 11, 1934, enumerated in the trial court's decree (R. 195). The Joint Company was not entitled to receive these dividends at the time of the trial court's decree and it is not entitled thereto today, not having proved its claim as required by law. The bank Receiver concedes that if and when restitution is made of the amount of the illegal payment, plus interest, the Joint Company has a valid general claim in the amount of $42,761.12 and *upon the filing thereof* the dividends heretofore paid other creditors should be paid immediately. However, the Joint Company would not be entitled to receive interest on these dividends because its failure to receive them when declared was due exclusively to its failure to file claim. Again quoting Mr. Justice Taft, speaking for the Circuit Court of Appeals for the Sixth Circuit in Chemical National Bank v. Armstrong, 59 Fed. 372, 383:

"We are of the opinion that no interest can be allowed on any dividends due the Chemical National Bank for the period between the time when such dividends were declared payable and the presentation of the claim to the bank. The damage to the Chemical Bank from this delay was self imposed."

The depositors of the Manufacturers' Bank have been forced to assume the expense of litigating this case to the court of last resort and, we submit, if they prevail the decree should include all sums to which they are legally entitled, even though this incidental question was not raised in the court below by their trustee, the Receiver, who was not selected by them but by the Comptroller of the Currency under the law.

This interest question is of class importance in the disposition of the numerous cases of this character pending in the lower Federal Courts, referred to in the Joint Company's petition for certiorari, pages 14 and 15, and a decision by this court would be of substantial assistance to the lower Federal Courts and the Comptroller of the Currency in resolving such matters. Substantial amounts are frequently involved, as in the instant case, having in mind that this bank suspended on June 13, 1931.

E.

Additional comments on petitioner's brief.

Most of the points argued in the petitioner's brief have already been covered.

The Federal decisions primarily relied on by the petitioners are McDonald v. Chemical National Bank, 174 U. S. 610; Hayden v. Chemical National Bank, 84 Fed. 874; Rucker v. Kokrda, 68 Fed. (2nd) 73 and Lucas v. Federal Reserve Bank, 59 Fed. (2nd) 617, 619. We vigorously contend that none of these decisions give the petitioners any assistance.

In McDonald v. Chemical National Bank, supra, the insolvent National bank at Lincoln, Nebraska, suspended at the close of business January 21st, a Bank Examiner took possession January 22nd, and a Receiver was appointed February 6th, all in 1893. On January 21st the Lincoln Bank's account with its New York correspondent—The Chemical National Bank—was overdrawn in the sum of $25,515.32. Prior to the suspension of the Lincoln Bank a number of items had been placed in the mails for credit to its account with the correspondent bank. These items were received and credited by the correspondent after suspension *but before the correspondent had knowledge of the suspension.* This court held that "the mailing of these checks and remittances was a *delivery* to the Chemical National Bank whose property therein was not destroyed or impaired by a *subsequent act* of bankruptcy." (Italics ours.)

This case in the Appellate Court was styled Hayden v. Chemical National Bank of New York (C. C. A. 2) 84 Fed. 874. The petitioners at page 33 of their brief state "A case very similar on the facts to the case at bar is Hayden v. Chemical National Bank, 84 Fed. 861." We quote the statement of the case from the Appellate Court's opinion (p. 875):

> "This action was brought by the Receiver of the Capital Bank to recover of the Chemical Bank the remittances thus received by it on and after January 18th. The court below held that the title to the remittances passed to the defendant at the time they were severally mailed to it, and, as *they had been transmitted in the usual course of business, before the Capital Bank had committed or contemplated committing any act of insolvency, and were received innocently by the defendant,* the defendant was entitled to apply them upon the balance of account owing to it by the Capital Bank.
>
> There is no evidence in the record showing or tending to show that the condition of the Capital Bank had materially changed recently, or that it was in a situation of greater financial stress after January 18th than it

was January 1st, or had been previously. So far as appears its officers expected, down to the time when its doors were closed, that it would go on with its business in the usual way in the future, as it had for the last year. Whether the failure was precipitated by a discovery of the real state of affairs by the bank examiner, or by the directors, and, if so, when the discovery was made, does not appear. *There is not the slightest evidence that the defendant was aware of or suspected the real situation.* It had at times refused to permit the Capital Bank to increase its overdrafts, but, as late as January 19th and 20th, notwithstanding the state of the accounts, it paid drafts of the Capital Bank.

Treating the remittances as payments, made at the time they were mailed, *the case presents the question whether payments made in the ordinary course of business by a National banking association, which is doing business as usual, to a creditor who received them innocently,* is void if it turns out that the [illegible]tion at the time had become in such sense insolvent that its debts were greatly in excess of its assets, and its officers knew or should have known the fact, and knew or should have known that probably at no very distant day it would be obliged to suspend." (Italics ours).

It thus appears that in McDonald v. Chemical National Bank, supra, the recipient of the alleged illegal payment was in New York City and the insolvent bank in Nebraska; that the items were received innocently by the defendant; that the New York correspondent bank had no information not available to other creditors concerning the Nebraska bank's condition; that there was no evidence that the condition of the insolvent bank had materially changed from January 1st to the date of its suspension; that so far as it appears the officers expected it could continue in business; that "there is not the slightest evidence that the defendant was aware of or suspected the real situation" and that the items had been remitted prior to suspension to a creditor who received them innocently. In the McDonald case this court said "* * * The evidence fails to disclose any intention or ex-

pectation on the part of its officers to presently suspend. • • • There is nothing to justify the inference that the particular payments in question were made in contemplation of insolvency or with a view to prefer the defendant bank." (Page 618).

How unlike the above facts are those presented in the instant case. In this case the payment was not received innocently by the Joint Company but came about through the "inside" information obtained by its agent, Ekstrom; *the Joint Company did have "inside" information* concerning the condition of the Manufacturers' Bank; there was evidence that the condition of the Manufacturers' Bank had changed, and the expectation that it could continue in business was materially changed on June 12, 1931, by the known inability of the Security National Bank to continue; the Joint Company through its agent was aware of the situation and the payment to it was not made or received innocently. In this case the evidence clearly discloses the intention or expectation on the part of its officers to presently suspend and there is ample evidence to justify the inference that the particular payment in question was made in contemplation of insolvency and with a view to prefer the defendant.

At page 30 of their brief appellants argue that the following excerpt from *Rucker* v. *Kokrda* (C. C. A. 10), 68 Fed. (2d) 73, 75, is applicable to this case:

> "When the payment was made, the decision to close the doors on the following morning had not been reached. That decision was not arrived at until late that night. True, the Officers knew that *unless new money was interested, or confidence restored,* the Bank could not indefinitely meet its customers' demands; but *when the payment was made, the Officers were hopeful the negotiations of the night would avert the necessity of an act of insolvency.* This payment was, therefore, not made in contemplation of the later act of insolvency." (Italics ours.)

We submit that the quoted language, when applied to the facts in the instant case, *establishes a violation of the section.* The Directors of the Manufacturers' Bank knew that unless new money was interested, or confidence restored, open insolvency was imminent. However, the only source of new money was the owners of their bank and their resources had already been exhausted. At the time of the payment here complained of the Directors had no hope that the negotiations of the night would avert open insolvency because they knew there was no prospect that the Third National Bank would take over their bank without a large additional payment in cash, which they knew could not be raised from any source prior to the opening of the next business day. In Rucker v. Kokrda as in McDonald v. Chemical National Bank the important fact was that the creditor had no "inside" information concerning the bank's condition. If the creditor had such information the payment would not be in the ordinary course of business and would violate the section. We emphasize that in the Rucker opinion the Appellate Court said at page 74, "There is no proof and no finding that he had any inside information as to the bank's condition * * * the day he closed his account."

We accept the following excerpt from Lucas v. Federal Reserve Bank, 59 Fed. (2nd) 617, 621, quoted in the petitioners' brief at page 36 as applicable but contend that the language we have emphasized rather than that italicized by the petitioners controls the facts in the instant case:

> "The purpose of the Statute was to guard against the wrongful or preferential disposition of the assets of a Bank by its officers, in contemplation of insolvency; and the knowledge and intent which it requires for avoiding a transfer, relate to the knowledge and intent on the part of the Officers of the Bank, who alone have the power to make the transfer. (Citing cases.)
>
> "As said by Judge Wallace in the case of Armstrong v. Chemical National Bank, supra, '*a Bank is not in contemplation of insolvency until the fact becomes rea-*

sonably apparent to its officers that it will presently be unable to meet its obligations and will be obliged to suspend its ordinary operations. On the other hand, if the Officers of the Bank make the transfer in contemplation of insolvency with a view of granting a preference, the transferee's knowledge, or want of knowledge, is immaterial.' (Citing cases). If the officers have no such knowledge or intent, it manifestly cannot be condemned as preferential, whatever may be the knowledge or intent of the transferee." (Italics ours.)

A long time of decisions, many of them recent, applying the illegal preference section, are annotated following Section 91, Title 12, U. S. C. A. We find no decisions reported, or unreported, that support the contention of the petitioners that Section 5242 U. S. R. S. was not violated by the payment complained of in this case.

The petitioners' brief at page 44 states, "We must know if Ekstrom directed the issuance of the check * * * admittedly it was not directed by him to be prepared." The record contains considerable testimony introduced in an effort to establish that the responsibility for the drawing of the check was that of a $225 a month bookkeeper or some minor employee or official other than Ekstrom. But Ekstrom admitted in his answer (R. 20), " * * * this defendant admits that he left said meeting at about 12:00 o'clock on said June 12, 1931, and * * * caused said check of $42,716.12 to be drawn," and (R. 21) "that this defendant caused said money to be drawn out."

The petitioners persist in stating to this court at page 8 of their brief that the Manufacturers' Bank had approximately one-half a million dollars in cash or its equivalent when it suspended, despite the correction at page 15 in the brief of the respondent in opposition to the granting of a writ of certiorari. We again insist that the available cash on deposit in the Federal Reserve Bank, according to the defendant's exhibit No. 5 (R. 171), referred to by the petitioners as authority for their statement, was $120,126.89 and

not $220,181.20 as stated by the petitioners. The uniform practice of Federal Reserve Banks to deduct a member bank's rediscounts in computing its available cash balance was testified to by Achor (R. 48-53-70), who had been a Federal Reserve Bank Examiner, and by Examiner Baty (R. 44) and page 2 of defendant's exhibit 5 (R. 172) lists the rediscounts in the amount of $100,054.92 which had been made with the Federal Reserve Bank and which sum the appellants again fail to deduct from the cash available at the Federal Reserve Bank. There is evidence (R. 44, 48) that the rediscounts totaled $156,000. The rediscounted items represented a liability of the Manufacturers' Bank to the Federal Reserve Bank and clearly the Manufacturers' Bank had a right to receive only such cash as remained after a reconcilement of the mutual accounts. Scott v. Armstrong, 146 U. S. 499, 508; Dakin v. Bayly, 290 U. S. 143, 148.

The Manufacturers' Bank did not have approximately half a million dollars in cash when it suspended, but had exactly $253,240.06 in cash on hand, total available deposits in all other banks $132,562.83, total $385,802.89. Some of the Directors of the Manufacturers' Bank testified that they thought this sum sufficient to face the run at the commencement of the next business day with a deposit liability of approximately $4,200,000. However, the Third National Bank, a sound bank operating today, was unwilling to face the deposit liability of the Manufacturers' Bank unless $750,000.00 additional in cash was raised prior to Monday's opening. That the position of the Third National Bank was absolutely sound and the Directors of the Manufacturers' Bank had no real hope that its open insolvency could be postponed for more than a few hours is clearly demonstrated by what occurred on Monday in Rockford when three banks suspended and the largest bank in the city suffered a loss of more than $700,000.00 in deposits (R. 64, 65, 45).

At page 19 of their brief the petitioners state:

> "If there was a bank in this great country during 1931 which did not have assets in its portfolio which

were criticized by the Comptroller it was the exception. If there was a bank at that period whose Officers were sure it was solvent in the sense that its assets at their then value were in excess of its liabilities, such a Bank was a rarity."

This statement is not supported by the facts, record or otherwise. But it was exceptional in 1931 for the Comptroller to write the Board of Directors of a National Bank a severely critical letter based upon a report of the bank's condition recently received advising them of the bank's "present dangerous situation," that "the bank is faced with potential losses that threaten its solvency" and requesting the Directors to "please also note the heavy borrowings of certain of the Directors and their concerns, approximately 31 per cent of the total loans and discounts, and the Examiner's statement that some of their lines are the weakest in the bank and heavy losses appear inevitable." Such a letter, accompanied by a copy of the report upon which it was based, was sent the Board of Directors of the Manufacturers' Bank (R. 248-254) and was received and examined by them, including Director Ekstrom (R. 30), a few days prior to June 12, 1931, the date on which the crisis at Rockford was precipitated by the inability of the Security National Bank to continue, and the day before the payment complained of.

Petitioners suggest at a number of places in their brief that the resolution to close the Manufacturers' Bank was passed under threat by the District Chief National Bank Examiner of criminal prosecution of the Directors by the Comptroller if the bank was kept open and further deposits received. The contention is not material to the issues of this case, and is not substantiated by the record. It is a fact that Ekstrom so testified, but he is not corroborated by the others present at the meeting. Achor testified (R. 62), "I did not hear him say that they would be prosecuted for receiving deposits if they kept the bank open." We submit that no such threat was made. The District Chief National

Bank Examiner knew the law and the Directors are charged with its knowledge. It is well settled by the decision of this court in Easton v. Iowa, supra, that no criminal statute is violated when the Directors or officers of a National Bank receive deposits under conditions of known insolvency.

The petitioners argue at page 52 of their brief that Ekstrom did not use the knowledge he obtained to prefer himself, pointing out that he did not withdraw his personal deposit. Of course Ekstrom knew that he would receive credit for this deposit 100 cents on the dollar through offset against his indebtedness to which he was entitled under the law, *Scott* v. *Armstrong, supra; Dakin* v. *Bayly, supra.* The situation was different as to the Joint Company in that it did not owe the bank; consequently the affirmative action taken was designed to save it from loss.

The petitioners, at page 78 of their brief, point to and discuss the use by the court below of the term "act of bankruptcy" instead of "act of insolvency." These terms are frequently used interchangeably and were so used by this court in *Chemical National Bank* v. *Armstrong, supra* (p. 40 this brief). This court treated the Bankruptcy law and the National Banking law as of practically the same import. *Rector* v. *City Deposit Banking Co.*, 200 U. S. 405-418.

ALLEGED ERROR OF TRIAL COURT IN ADMITTING IN EVIDENCE RESPONDENT'S EXHIBITS 22, 24 AND 25.

Pages 99-106 of petitioners' brief relate to the contention that certain bank examiners' reports and certain letters from the Comptroller to the bank (Respondents' Exhibits 22, 24 and 25; R. 242-254) were improperly admitted in evidence.

The testimony of Ekstrom (R. 28, 30) establishes that he read and/or was cognizant of the contents of these documents; and findings Nos. 13 and 15 of the trial court (R. 189, 190) likewise so indicate.

Consequently these documents were admissible for the purpose, inter alia, of establishing that Ekstrom, as a director of the bank, had knowledge of the condition of the bank as found by the Comptroller through the national bank examiners, and other officers of the Comptroller's office who were required by law to examine the bank and report to the Comptroller for such action or criticism as the Comptroller might consider proper under the circumstances. Guthrie v. Harkness, 199 U. S. 148, 156.

Such knowledge on the part of Ekstrom was, of course, a material and relevant fact on the issues of preferential withdrawal of funds of the Joint Company and Ekstrom's personal liability in connection therewith.

The knowledge of Ekstrom, as to the condition of the bank, both as derived from the aforesaid documents and from other sources and transactions, such as directors' meetings and conferences, were necessarily imputed to the Joint Company when he acted for the Joint Company in its transactions affecting the affairs and condition and assets of the bank. As stated by the Court below (R. 236, 237):

> "It is contended, however, by appellants that the evidence conclusively shows that the check was drawn and signed before the bank directors' meeting on June 12; that Ekstrom did not order the check drawn nor divulge to the Mechanics Company or its agents any information received by him at the directors' meeting; and that neither the drawing of the check nor the money was caused by any information received from Ekstrom. Without conceding it, we shall treat the language of these contentions as tantamount to saying there was no substantial evidence to support the court's findings in these respects. It would serve no good purpose to set forth the evidence in detail. A perusal of the entire record convinces us that with respect to both appellants, the court's findings are supported by direct material evidence as well as by logical and legitimate inferences. It is further contended, however, that the court will not indulge in the presumption that Ekstrom divulged to others any information received from the bank direc-

tors' meeting. That may be conceded, but the court's findings and conclusions are not based on that presumption. That Ekstrom signed the check as president of the company after he left the bank directors' meeting is supported by material evidence, and he neither affirmed nor denied it. He was an officer of the Mechanics Company, as well as a director of the bank, hence it was not necessary for him to divulge any information to accomplish the withdrawal of the funds. He, whose signature gave vitality to the check, already had the information when he signed it. That act was his company's act, and his information at that time was his company's information. These circumstances, we think, constitute a sufficient basis for the court's conclusions Nos. 4, 5, 6, and 7, 8, 9."

On the general proposition that notice to the agent is imputed to his principal, see:

St. Louis Ry. Co. v. *Johnston*, 133 U. S. 566, 576.
Curtis, Collins & Holbrook Co. v. *United States*, 262 U. S. 215, 222, 223.
Mutual Life Ins. Co. of New York v. *Hilton-Green, Executors*, 241 U. S. 613, 622.

The hopelessly insolvent condition of the Manufacturers' Bank at the time of the payment is established by the bank's books and records plus the other facts known to the directors. Ekstrom and the other directors had undertaken to take part in the management of the bank and had sworn to be diligent in the performance of their duties. They knew the contents of the Examiner's reports of the condition of the bank and the Comptroller's severely critical letters. The directors were bound to take cognizance of the facts concerning the bank's condition pointed to and commented on by the Comptroller and the Examiner. Achor who was the bank's vice-president testified at length as to the bank's condition about the time of the payment and to the fact that the Examiner's report correctly reflected the bank's condition (R. 54). Examiner Baty's comment concerning the bank's condition at the directors' meeting on

June 12, 1931, was based on the bank's books and records, available to the directors. The directors could verify if they saw fit, Examiner Baty's statements concerning the bank's low cash position; its inability to raise further funds; and being present in Rockford the directors certainly knew that the crisis that did occur would occur at the opening of business on Monday. Neither Ekstrom nor his associates can be heard to say that they did not know what they should have known, as a matter of law, had they diligently performed their duties as directors.

CONCLUSION.

The Bank Receiver respectfully submits that under this record and the authorities discussed this court should affirm the decision of both courts below that the payment complained of violated Section 5242 U. S. R. S. and affirm the judgment given against both appellants except that the decree of the trial court should be modified to give the Receiver judgment for the amount of the payment plus interest thereon at the legal rate from June 13, 1931, to the date of restitution, without crediting thereon dividends paid to the bank's creditors as of the dates paid, permitting the Joint Company to receive the dividends that will be due on its general claim, without interest thereon, when its claim is filed with the Receiver.

Respectfully submitted,

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Attorneys for the
Comptroller of the Currency,
Of Counsel.

APPENDIX.

Section 192, Title 12, U. S. C. A.

DEFAULT IN PAYMENT OF CIRCULATING NOTES. On becoming satisfied as specified in sections 131 and 132, that any association has refused to pay its circulating notes as therein mentioned, and is in default, the Comptroller of the Currency may forthwith appoint a receiver, and require of him such bond and security as he deems proper. Such receiver, under the direction of the Comptroller, shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct; and may, if necessary to pay the debts of such association, enforce the individual liability of the stockholders. Such receiver shall pay over all money so made to the Treasurer of the United States, subject to the order of the Comptroller, and also make report to the Comptroller of all his acts and proceedings.

Provided, That the Comptroller may, if he deems proper, deposit any of the money so made in any regular Government depositary, or in any State or National bank either of the city or town in which the insolvent bank was located, or of a city or town as adjacent thereto as practicable; if such deposit is made he shall require the depositary to deposit United States bonds or other satisfactory securities with the Treasurer of the United States for the safe-keeping and prompt payment of the money so deposited. Such depositary shall pay upon such money interest at such rate as the Comptroller may prescribe, not less, however, than 2 per centum per annum upon the average monthly amount of such deposits. (R. S. 5234; May 15, 1916, c. 121, 39 Stat. 121.)

Section 194, Title 12, U. S. C. A.

DIVIDENDS ON ADJUSTED CLAIMS; DISTRIBUTION OF ASSETS. From time to time, after full provision has been

first made for refunding to the United States any deficiency in redeeming the notes of such association, the Comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held. (R. S. 5236.)

Section 73, Title 12, U. S. C. A.

OATH. Each director, when appointed or elected, shall take an oath that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association, and will not knowingly violate or willingly permit to be violated any of the provisions of this title, and that he is the owner in good faith, and in his own right, of the number of shares of stock required by this title, subscribed by him, or standing in his name on the books of the association, and that the same is not hypothecated, or in any way pledged, as security for any loan or debt. The oath shall be taken before a notary public, properly authorized and commissioned by the State in which he resides, or before any other officer having an official seal and authorized by the State to administer oaths, except that the oath shall not be taken before any such notary public or other officer who is an officer of the director's bank. The oath subscribed by the director making it, and certified by the notary public or other officer before whom it is taken, shall be immediately transmitted to the Comptroller of the Currency and shall be filed and preserved in his office for a period of ten years. (R. S. 5147; Feb. 20, 1925, c. 274, 43 Stat. 955.)

Memorandum of conclusions and order for judgment

No. 5063-J.

United States District Court, Southern District of California—Central Division.

N. F. Schilling, as Receiver of The United States National Bank of Los Angeles, a national banking association, Plaintiff, vs. A. Sieroty, also called Adolph Sieroty, and Bertha Sieroty, husband and wife, Defendants.

The United States National Bank of Los Angeles suspended on August 18th, 1931, and has since been in charge of the plaintiff receiver, appointed by the Comptroller of the Currency. For several years prior to August 8, 1931, defendant Bertha Sieroty maintained a term account (apparently her separate funds) with the bank. No withdrawals had been made since August, 1929, until a check closing the account was debited on August 8, 1931. This check was for the amount of $5,902.78 and was made payable to Adolph Sieroty, the depositor's husband, who was at the time a director of the bank and had been such throughout the year 1931 and up to the closing date of the bank. The check was dated July 31, 1931.

The receiver has sued to recover this deposit under the provisions of Title 12, U. S. C. A., Section 91, which, in parts material here, provides that payments of money by a national bank "made after the commission of an act of insolvency, or in contemplation thereof, . . . with a view to the preference of one creditor to another . . . shall be utterly null and void."

Defendant A. Sieroty disclaimed that he knew of any condition of threatened insolvency of the bank. It appears that not only did he withdraw his wife's deposit at the date mentioned, but also that three large business concerns in which he was, with his family, largely interested, and which had carried very large term accounts with the bank, closed their accounts on August 3rd, 6th and 8th, 1931. These accounts had been on the books since the year 1929. The account of Minna Falk, wife of a nephew of A. Sieroty, was also closed by check dated August 12, 1931, the check being payable to A. Sieroty.

The explanation given by the defendants' witnesses as to why the accounts were closed at dates so close to the suspension of business by the bank, which explanations sought to attribute to the acts anything but the important reason of anticipated insolvency of the institution, are not convincing. In the light of facts which will be later stated, the real reasons and purposes are made plain enough.

The decisions cited by the several counsel have been given careful study and need not here be reviewed, as it is my intention to state the conclusions that I have arrived at only, with such a review of the evidence as is necessary to illustrate them.

Under the terms of the statute it is of course necessary that it be shown that at the time the money was paid out closing Bertha Sieroty's account, insolvency of the bank was anticipated by the directors. Not insolvency in the sense of the Bankruptcy Act, but a situation reached where in the ordinary course of its business the bank could not meet its obligations as they fell due; the intent and purpose of the depositor being an immaterial factor. Here the intent of the depositor was bound up with that of the husband, who was a director of the bank. That the depositor's decision to withdraw her account was made in fact by the husband there can be little doubt, notwithstanding that Mrs. Sieroty said that she, herself, had decided to withdraw because she entertained some dislike for a Mr. Cohen, who had been executive vice president of the bank. The fact was that Cohen had resigned his office more than a month and a half prior to the date when Mrs. Sieroty's account was closed.

Coincident happenings may be often-times remarkable through the result of mere chance, but the occurences respecting the sudden closing of all accounts in which Director Sieroty had an interest, are consistent only with one purpose and design. A summary of facts shown by the evidence is convincing of the correctness of this statement:

The bank, by voluntary act of the directors, closed its doors on August 18, 1931. From an early date in the year 1931, its condition had not been such as to satisfy the Examiners of the Comptroller's department. The most material source of a bank's revenue is ordinarily its interest earnings on loans. The examiners were critical of the loans, estimating many of them as doubtful or wholly

valueless. Loans to directors, and notes upon which directors' names appeared as indorsers, were also made question of. The report of the examiners under date of April 16, 1931, contained the following statements:

"Laden with slow and doubtful assets, this bank presents a serious problem. The committee of the board of directors has said that $100,000.00 is all that can be raised at this time; hence the problem at this time resolves itself into a workout, with the hopes that a portion of the assets can be rehabilitated into collectible loans, and that the bank's earnings will protect the remainder thereof, . . . Under proper management and the accumulation of profits faster than the accrual of losses, if the bank can show a continued improvement, *there is a possibility*, over a long period of time, of the bank working from under its asset position. If, however, losses accrue faster than accumulated profits, and the general asset condition becomes worse, additional funds will have to flow to the profit account through statutory means, or otherwise." (Italic face type added in emphasis of view of examiners that at best there was a *possibility* of improvement, rather than a probability.)

On July 2, 1931, the Comptroller wrote to the bank's directors: "Bank's condition from the standpoint of undesirable assets is decidedly unsatisfactory. As the examiner states it presents a serious problem . . . It is hoped that you will be able to prove the worth of all the listed loans and at least keep losses within a figure that can be taken care of through the bank's earnings."

Efforts had been made from early in 1931 by the directors to improve the cash position of the bank without success. At a meeting of the board held in June, 1931, it was decided to omit dividend to stockholders. Such was the precarious state of the bank's business when, as a climax to its misfortunes, the claim was made by the receivers of the Ferguson trusts, on July 6, 1931, for an amount in excess of $2,000,000, allegedly due because of the negligence of the trust department of the bank, in the handling of those trusts. Aside from the difficulty which the bank faced in the matter of producing cash enough to meet any considerable part of this demand, the fact that it was asserted that its officers had been so careless as to cause a liability against

the bank, was bound to react against the institution's credit and reputation. It did so react. While at no time during 1931 had the bank been able to increase greatly its deposits, from the last of July, 1931, up to the time when the bank closed its doors on August 18, 1931, deposit balances fell off daily. On August 18, 1931, deposits were more than $3,000,000 less than they were on July 31st preceding.

When the bank closed its doors, national bank examiners immediately checked up its books. Of a total "loan and discount" schedule of $5,234,732.56, the appraisement of the examiners was that there was a total loss of $1,031,-233.30, as for bad loans, with $202,953.63 of doubtful value. The estimated loss over capital structure (capital plus surplus and undivided profits) was $201,846.76. On the loan list was found a total of loans to directors of $551,675 with $188,300 unsecured. In addition to this, directors had indorsed notes of others to the amount of $171,950.

While the directors of the bank who testified in the case affirmed the belief that they had considered that the bank could pay its liabilities prior to closing, it appeared that they had appealed to the Los Angeles Clearing House for assistance in settling the Ferguson trusts claims at a compromise figure of $400,000. They had been unable to get the needed assistance. One director said: "The bank had no funds to carry out the deal—The bank didn't have cash to meet the demands." Mr. W. B. Heim, secretary and director of the bank, testified that rumors concerning the Ferguson trusts claims were current sixty days before the bank closed, and that the bank officers attributed the withdrawals of deposits almost entirely to those rumors.

The receiver who was appointed to liquidate the bank's business estimated a deficit between resources and liabilities of over $1,000,000, not including the Ferguson trusts claims. By assessment against stockholders he estimated that the deficit might be reduced one-half.

And now, what was the knowledge of defendant A. Sieroty of the bank's condition at the time he caused the deposit of his wife to be withdrawn on August 8, 1931? He had been a director of the bank at all times material here and until the closing date. He attended the meeting in June of the directors when the dividend was ordered to be omitted. He was present at the directors' meeting of July 29th when the letter dated July 2, 1931, from the Comptroller, was read (as hereinbefore referred to). At the

same meeting a firm of attorneys was employed to advise the board regarding the Ferguson trusts claims. Aside from any presumptive knowledge that may be properly charged to the mind of directors, (the managing agents of the stockholders), the record in this case is complete in its showing of facts and circumstances showing that defendant A. Sieroty was well aware of the hazardous condition attending the future of the bank, even before the Ferguson claims were put forward. Income had fallen off; the bank examiners and the Comptroller's office had indicated that new resources must be acquired. Deposits diminished from the end of July. Whatever a director may say by word as to his lack of belief in the bank's stability, he will be held to have knowledge of those things which his duty required him to be informed of. In this case the express showing of the evidence makes it unnecessary to rely alone upon the presumption.

And a director of a bank, having knowledge of the probability that his bank will close its doors, who influences the withdrawal of deposits made by persons connected with him in the family relation, all with the purpose of seeing that such depositors secure one hundred per cent of their deposits, where if such deposits remained until the bank closed returns would be delayed and fractional amounts only returned, fails in his duty to the creditors of the bank. The case is to be considered in a different light from a case where a depositor continues his regular business of depositing and withdrawing money up to the date when the bank closes its doors. It does not follow that such last withdrawals may be recovered. Such payments by the bank do not come within the qualification of the statute as being made "with a view to the preference of one creditor to another." Every bank up to the moment of its actual closing, ordinarily proceeds to do banking business. Here we know that the bank was in such a condition as that when the trusts demands were made, it was powerless to escape closing unless outside money could be obtained; there was the *hope* on the part of the directors that money might be procured, and it was with this hope in mind that the doors were kept open. Efforts to raise money failed. To permit Mr. Sieroty, as agent for his wife, to exercise his discretion as to the proper time to save his wife's deposit intact, at the expense of other creditors, would contravene the plain purpose of the statute.

The bank allowed the deposit to be withdrawn with full knowledge of the conditions stated. The closing of the bank was apprehended as a probability—such closing establishes insolvency. It matters not that the bank in liquidation might be able to pay a large percentage of its liabilities. If it does, then depositing creditor here will receive proportionate dividends.

Findings and judgment will be in favor of the plaintiff against Bertha Sieroty, to which an exception will be noted.

Dated August 21, 1934.

WM. P. JAMES
U. S. District Judge.

THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF MICHIGAN, SOUTHERN DIVISION

No. 3656

DAVID E. UHL, Receiver of the Grand Rapids National Bank, *Plaintiff*,

vs.

THE FIRST NATIONAL BANK & TRUST COMPANY, of Kalamazoo, Michigan, a national banking corporation, *Defendant*.

This suit is brought under section 91, Title 12 U. S. C. A. (R. S. sec. 5242), which in effect declares null and void all payments of money by a national bank to creditors after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by the National Bank Act, or with a view to the preference of one creditor to another. The obvious purpose of this section and of section 194 of the same title is to secure equality of distribution of the assets of an insolvent bank among its creditors. (See Smith v. Baldwin, 69 F. (2d) 390, and Jennings, Receiver, v. United States Fidelity & Guaranty Company, U. S. Sup. Ct., February 4, 1935.) Plaintiff seeks recovery of the sum of $115,107.58 alleged to have been withdrawn in circumstances which resulted in an unlawful preference.

Waiver of jury trial was duly filed.

The parties are in accord upon many of the important facts, and recognize the fundamental principles of law applicable thereto, as stated in Nelson *v.* Lewis 73 F. (2d) 521, 523—

> "If the financial condition of a bank is such that an actual act of insolvency is imminent, and the officers of the bank know or ought to know this condition, a payment to a creditor or depositor is void if not made in the ordinary course of business; an intent to prefer is presumed under such conditions, and as a rule the creditor and depositor need not know of the imminency of the act of insolvency. National Security Bank v. Butler, 129 U. S. 223, 9 S. Ct. 281, 32 L. Ed. 682; Federal Reserve Bank of Kansas City v. Omaha Nat. Bank

(C. C. A.) 45 F. (2d) 511; Parks v. Knapp, 29 F. (2d) 547 (C. C. A. 8); American Surety Co. of N. Y. v. Jackson, 24 F. (2d) 768 (C. C. A. 9); Brill v. McInnes, 14 F. (2d) 306 (C. C. A. 8)."

The controversy arises from the fact that at the time of the alleged preferential payments, a banking moratorium pursuant to proclamations of the Governor was in effect in the State of Michigan. Defendant takes the position that the withdrawals complained of were made in the ordinary and usual course of business transacted between defendant and the Grand Rapids National Bank, and were not actuated by knowledge of insolvency.

The situation so far as material to the issues is as follows,—On February 11, 1933, defendant had on deposit in the Grand Rapids National Bank $121,099.46. The Bank was closed on both February 12th and February 13th, the 12th falling on Sunday and the 13th being observed as Lincoln's Birthday, a legal banking holiday by statute. In the early morning of February 14th, a proclamation was issued by the Governor which proclaimed the days from Tuesday, February 14, 1933, to Tuesday, February 21, 1933, both inclusive, to be public holidays, "during which time all banks, trust companies and other financial institutions conducting a banking or trust business within the State of Michigan shall not be opened for the transaction of banking or trust business, the same to be recognized, classed and treated and have the same effect in respect to such banks, trust companies and other financial institutions as other legal holidays under the laws of this state, provided that it shall not affect the making or execution of agreements or instruments in writing or interfere with judicial proceedings". The bases for the proclamation were recited to be an acute financial emergency existing in the City of Detroit and throughout the State of Michigan, and requests by the Michigan Bankers Association and the Detroit Clearing House. The Grand Rapids National Bank was closed, pursuant to this proclamation, from February 14th to February 21st, inclusive, and also on February 22nd, a legal holiday. On February 21, 1933, the Governor issued a second proclamation which announced "that all banks, trust companies and other financial institutions conducting a banking or trust business within the State of Michigan prior to said holiday, shall be opened for the transaction of

business at the regular opening hour on the morning of Thursday, February 23rd, 1933, provided, however, that such business shall be limited to the following functions:

"1. Reserve deposits shall be available to depositing banks and may be drawn without creating a preference.

2. Payments to depositors in either commercial or savings departments shall be limited in amount to the proportion the total individual deposit bears to the cash on hand, available reserves in banks and United States Government bonds in each such department. Such payments shall only be allowed for necessary purposes, such as payrolls, bank transit items created on and after February 23, 1933, necessary living expenses, tax payments, or other obligations to the State of Michigan and subdivisions thereof, or to the Federal Government, drafts with bill of lading attached, Reconstruction Finance Corporation monies on deposit for welfare purposes, and such other purposes necessary for the ordinary conduct of business, providing always that no depositor shall be preferred as against any other depositor.

3. Banking institutions may take new deposits, but such deposits shall be treated as trust deposits, and there shall be opened in each such institution a trust deposit department. Such deposits shall be payable on demand without interest and held solely for the repayment of such depositors.

4. Banks and trust companies acting in a fiduciary capacity may perform their duties and discharge their obligations in such capacity, provided that in the exercise of such fiduciary functions debtor and creditor relationship shall not be involved.

5. Such modifications in the foregoing limitations as may be necessary in extraordinary cases may be allowed with the consent of the State Banking Commissioner, provided, however, that no depositor shall be preferred as against any other depositor."

"The bank holiday heretofore proclaimed by me shall continue in effect subject to the foregoing limitations until otherwise ordered by me."

It will be observed that by the terms of this second proclamation, reserve deposits were permitted to be withdrawn without limitation.

On February 22, 1933, the board of directors of the Grand Rapids National Bank, in common with the other banks of Grand Rapids, decided to pay 5% to all commercial, savings, and certificate of deposit depositors; to accept so-called trust or demand deposits which would be held separate and not subject to restrictions; and to return all outstanding checks dated prior to February 23, 1933. This decision was carried into effect and on the morning of February 23, 1933, the bank reopened on the limited basis indicated as to general depositors but released the deposits of other banks without limitation. The bank never reopened for regular business, but continued for about four months to accept deposits having the status of trust funds.

On or about March 20, 1933, efforts were made to bring about a reorganization of the bank by obtaining subscriptions to capital stock by depositors to the extent of 25% of their deposits under a plan whereby the entire pre-existing capital stock and surplus were to be cancelled. These efforts were continued until about June 29th. The federal authorities refused to sanction the plan, and a Conservator was appointed on that date. The affairs of the bank were conducted by the conservator until September 25, 1933, when David E. Uhl was appointed receiver.

Later, certain of the assets were sold to a new bank known as the National Bank of Grand Rapids and the remaining assets were left in the hands of the receiver for liquidation. Dividends of 50% and 10% have thus far been paid to creditors largely from the proceeds of government loans obtained by pledging assets.

On April 7, 1933, an act of the Michigan legislature became effective which declared an emergency in respect to the banking and credit structure of the state, authorized the Governor to declare public holidays to be observed by banks, trust companies and other financial institutions, and ratified and confirmed any proclamations previously issued in respect of the emergency, and the acts of banks performed pursuant to such proclamations. (See Act 47 of Public Acts of Michigan of 1933.)

There is no dispute that on February 11, 1933, defendant's net balance in the Grand Rapids National Bank (after deducting certain items returned dishonored) was the sum of $121,046.65. This entire amount was withdrawn by defendant during the period between February 23, 1933,

and March 10, 1933, on which date there was an overdraft. Plaintiff concedes that defendant, in common with other depositors, was entitled during that period to withdraw 5% of its balance and that defendant was entitled to be credited with a small item of interest, leaving the balance of $115,107.58 for which plaintiff asks judgment in this action.

The problem presented is whether or not the payments made to defendant between February 23rd and March 10th were made after the commission of an act of insolvency or in contemplation thereof, and were made with a view to prevent the application of the assets of the bank in the manner prescribed by the National Bank Act. Material aid in the solution of this question is afforded by the report of examination of the bank made between February 3rd and February 10, 1933. A summary of this report of the national bank examiners is attached as Note I. The report discloses that the control of the bank was owned by the Guardian Detroit Union Group of Detroit; that the entire capital and surplus of the bank was $1,300,000; that loans had been made to directors, officers and employees in the aggregate of $754,215.60; that of this amount over $300,000 was without collateral, and that large amounts of the deposited collateral to secure loans had become practically worthless; that the directors, officers and employees had assumed further liabilities as endorsers or guarantors to the amount of $194,056.49; and that loans had been made to corporations or enterprises in which the directors or officers were largely interested to the amount of approximately $288,000. It is clear that the margin of safety commonly afforded by capital and surplus had been largely absorbed by those charged with responsibility for the solvency of the bank.

Of the total loans and discounts of $8,473,470.59, the examiners listed $3,790,694.08 as slow, $1,227,050.37 as doubtful, and estimated losses thereof at $84,468.03.

They also reported that the bonds and securities held by the bank had depreciated to the extent of $437,881.24. The report also disclosed an indebtedness upon a portion of the bank site to the extent of $200,000. The examiners' report concluded as follows:

> "With the heavy concentration of criticised assets, the bank has a major problem confronting it, and the

directors were advised of their responsibility in connection with the large amount of doubtful items now being carried. * * * With the large amount of money invested in banking house, the inadequacy of the bank's capital structure is readily apparent."

When it is considered that the demand deposits at the time of the report amounted to $6,776,990.26; that the time deposits amounted to $5,447,164.74; that in addition thereto the amount due banks and trust companies was $1,420,925.03; and that government deposits amounted to $67,476.56; it is obvious that the condition of the bank was precarious prior to the proclamation of the bank moratorium.

The record discloses contradictory opinion testimony as to whether on February 11, 1933, the bank was solvent or insolvent, based upon comparative values of resources and liabilities. There can be no doubt that, if solvent at that time, it was by a narrow margin.

When there was projected into the situation following the proclamation of February 14th the hysteria and panic resulting from the fear engendered in the mind of the public for the safety of its funds, it became apparent that the bank could not reopen in the ordinary course of business. The careful examination of the assets of the bank made by and on behalf of the officers and directors during the eight days following must have forced the conclusion not only that the bank could not presently open in the usual course but that there then existed no reasonable prospect that it would be able so to do at any future time. The most optimistic plan for reopening which was evolved was the one of about March 20th, predicated upon the complete surrender of all capital stock and surplus, and surrender by depositors of their rights as creditors to the extent of 25 per cent of their deposits, a total elimination of liabilities of an amount considerably in excess of $4,300,000. After several months of determined effort, this plan was rejected not only by depositors but by federal authorities. The promulgation of such plan was in itself convincing evidence of recognition of a then existing state of hopeless insolvency.

No proof appears of any unusual event or circumstance which substantially affected the value of the assets of the Grand Rapids National Bank between February 22nd and March 20th. If conditions such as those suggested on that later date were necessarily to permit reopening the bank, it

must be assumed that substantially the same situation existed at the dates of the alleged preferences.

The case of *Hirning* v. *Federal Reserve Bank of Minneapolis*, 52 F. (2d) 382, held that a resolution of the board of directors of a bank suspending the bank's operations was an "act of insolvency." The authorities agree that a national bank is "in contemplation of insolvency" when the fact becomes reasonably apparent to its officers that it will presently be unable to meet its obligations and will be obliged to suspend its ordinary operations. (See *First National Bank of Ortonville, Minn.* v. *Andresen*, 57 F. (2d) 17; *Browne* v. *Stronach*, 7 F. (2d) 685.)

The judgment of the court is that, at least at the time of the determination by the directors of the Grand Rapids National Bank on February 22nd, that the bank would reopen only on a basis which amounted to the impounding of 95 per cent of the deposits, and which involved the dishonoring of all checks dated prior thereto, it was clear that the bank could not meet its obligations and that it could never resume its usual course of business. Judicial notice may be taken of the fact that some banks refused to close under the proclamations of the Governor and that many others soon after the period of closing resumed business. Many entirely solvent banks closed and others of doubtful solvency were probably rendered insolvent as the result of the proclamations.

Defendant urges that the transactions here complained of were justified because the defendant and the Grand Rapids National Bank after February 22nd carried on the same business relations and transacted the same sort of business between themselves as they had engaged in prior to February 11, 1933, and that therefore the transactions were in the ordinary course of business as between them. It also urges that there was no thought of insolvency of the Grand Rapids National Bank at the time the withdrawals complained of were made, and that there was no reason then to believe that the bank would not open on an unrestricted basis at an early date. It is stated that the transactions between the two banks may properly be said to have been "in the ordinary course of business" within the meaning of the rule. As indicated, the court does not concur in these views.

Payment of funds by an insolvent bank to a reserve bank was held void as a preference in the case of *Vann* v. *Fed-*

eral Reserve Bank of Richmond, 47 F. (2d) 786. In the case of *National Security Bank* v. *Price,* 22 F. 697, it was held that after a vote of directors to close the bank and go into liquidation, any transfer of assets to a creditor whereby that creditor secures a preference will be presumed to have been made with a fraudulent intent. This case was affirmed in *National Security Bank* v. *Butler,* 129 U. S. 228.

The case of *Varden* v. *City of Corbin, Ky., et al.,* 2 F. Supp. 840,841, holds that where the nature and probable consequence of a transfer of notes to depositors was to prefer such depositors, the officers cannot claim that a preference was not intended. The court said:

> "Whether the officers of the bank realized to the full extent that such was its condition at this time, it was 'reasonably apparent' that such was the case. They should have realized it and closed its doors. * * *
>
> "Here the natural and probable consequences of these transfers was to prefer, and the officers cannot be heard to say that they did not intend to prefer."

It is true that the banking moratorium created a novel situation and one which necessitates careful scrutiny of the facts in suits arising therefrom. Wherein recovery is sought of alleged preferences under section 91. No rule of general application can be stated. Decisions on issues arising in this field must be narrowly confined within the bounds of the facts of each case, because differentiating circumstances may lead to different results.

Emergencies, when met not with caution and wisdom but by hasty action frequently become catastrophes. Confused and contradictory explanations immediately following the first proclamation by the Governor induced general belief that financial or industrial powers were struggling for control, with the result that what had been at most a local emergency became nationwide chaos. Prior to the proclamation, the Grand Rapids National Bank, with practically its entire capital and surplus loaned to directors or their enterprises, had possessed a species of doubtful solvency, depending on uninterrupted activity for such stability as it possessed. Following the proclamation, this stability came to an end and, had the officers stopped to consider the situation, they must have seen that ultimate failure was inevitable.

It is impossible to conceive any basis for a claim that the Governor's proclamation of February 21st afforded justification for preference of deposits made by banks, or that the Michigan legislature could give validity to such preferences by the act of April 7, 1933. Both the Governor's proclamation and the act of the legislature attempting to ratify the same were entirely nugatory so far as applied to the distribution of assets of national banks. The proclamation resulted in withdrawals from the Grand Rapids National Bank within ten days after February 22nd of in excess of $560,000 by banks, while public moneys and private deposits were impounded to the extent of 95 per cent. This followed naturally from the clear usurpation of the powers of Congress by the state executive. The ultimate result was a 5 per cent distribution to those whose rights were invaded and 100 per cent distribution to many of those whose sanction and advice induced the action.

In the case of *Davis* v. *Elmira Savings Bank*, 161 U. S. 275, 283, it is said:

> "National banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It follows that an attempt, by a State, to define their duties or control the conduct of their affairs is absolutely void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the Federal government to discharge the duties, for the performance of which they were created. These principles are axiomatic, and are sanctioned by the repeated adjudications of this court."

A similar holding by Justice Day is found in the case of *Van Reed* v. *People's National Bank*, 198 U. S. 554, 557,—

> "National banks are quasi-public institutions, and for the purpose for which they are instituted are national in their character, and, within constitutional limits, are subject to the control of Congress and are not to be interfered with by state legislative or judicial action, except so far as the lawmaking power of the Government may permit."

Also, in the case of *Gilbertson* v. *Northern Trust Co.*, 207 N.W. 42, it was held that no state statute can override the prohibition of the National Bank Act relating to preferences. (Se also, 7 C.J. 760.)

Application of these principles to the facts established by the record brings the conclusion that plaintiff is entitled to judgment. Findings of fact and conclusions of law, and proposed amendments thereto, may be submitted for signature on or before February 23, 1935, after the filing of which judgment will be entered in favor of plaintiff and against defendant for the amount of the preference with interest at 5 per cent from March 10, 1933, less the amounts of the dividends declared by the receiver with interest thereon.

(Signed) FRED M. RAYMOND.
United States District Judge.

Dated February 15, 1935.